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No. 503

Supreme Court of the United States.

October Term, 1925.

UNITED STATES - - - - - *Petitioner,*
vs.

BUTTERWORTH-JUDSON CORPORATION.

*On Writ of Certiorari to the United States Circuit
Court of Appeals for the Second Circuit.*

BRIEF FOR THE UNITED STATES.

References required by Rule 25.

(a) The opinions below have not been reported (District Court R. 21; C. C. A. R. 26).

(b) The jurisdiction of this court was invoked by a writ of *certiorari*, which, on June 1, 1925, was granted, under Judicial Code §240 (a) as amended by the Act of February 13, 1925, to review a final decree entered March 10, 1925 (R. 23) in an equity suit pending in the Southern District of New York, entitled *Hay Foundry & Iron Works vs. Butterworth-Judson Corporation* (where the jurisdiction depended solely on diverse citizenship); wherein the United States, by intervening petition, had sought a priority of payment of its debt under §3466 Rev. Stats. (R. 2-9), which priority was refused and its petition dismissed (R. 23).

The Question Involved

Technically, the question involved is whether an equity "consent receivership" is either (1) a "voluntary assignment" under §3466 Rev. Stat., or (2) an "act of bankruptcy" under §3a (4) of the Bankruptcy Act of 1898, as amended in 1903.

Concretely, the question is whether the Government's statutory right under §3466 to a priority in the payment of debts owing to it by insolvent debtors can be successfully defeated by the joint action of the insolvent debtor and the other unsecured creditors, in utilizing the reorganization device (latest edition) of a "consent receivership" by which (a) a simple contract creditor files a bill in equity for a receiver, alleging that the debtor is solvent—when he is really insolvent in the bankruptcy sense—in order to evade the Bankruptcy Act, §3a (4), and (b) the debtor, pursuant to an express prior agreement with his creditors, *waives* his defense of an adequate remedy at law, *admits* all the allegations of the bill (including the untrue averment of his solvency), and affirmatively *consents* to the receivership.

By that device, bankruptcy is avoided on the one hand; the effect of §3466 is avoided on the other hand; and the United States is reduced to the status of a general unsecured creditor of a debtor, who is in fact insolvent in the bankruptcy sense, and who has been divested of all his property and assets for administration and distribution among his creditors through an equity receivership. That we have cor-

rectly outlined the effect of this device is shown in the petition for *certiorari* (p. 3, 4) in *Price, Receiver v. U. S.* recently granted (No. 454, October Term, 1925), where its *widespread adoption* is urged as a reason for granting the writ in order that this Court may settle the propriety of the practice.

STATEMENT OF THE CASE

1. *The "consent Receivership."* On April 22, 1922, four New York banks appropriated to their own use \$528,000 which Butterworth-Judson Co. had on deposit with them in a "special account" (R. 4)—an appropriation held to be unjustifiable in *U. S. v. Butterworth-Judson Corp.* 267 U. S. 387, where it was decided that the United States could recover the \$528,000 from the banks, because the deposit was impressed with an equitable lien in favor of the United States.

On the same day, April 22, 1922, the Hay Foundry & Iron Works, a simple contract creditor, filed a creditor's bill, in the usual form, against the Butterworth-Judson Co. alleging the latter's financial difficulties, and praying for the appointment of a Receiver to take charge of

"all and singular the property and assets of every nature, wheresoever situated, held, owned, or controlled by the defendant";

with the customary broad prayer that the business be operated by the Court; that the defendant deliver possession of all its property to the Receivers;

that the defendant and its agents be enjoined from any interference with, or any disposal of, any of the property; that all persons be enjoined from bringing suits or from taking the property; and that the property be sold and divided among its creditors (R. 12-16)—“all with the full knowledge and consent of Butterworth, Judson Corporation” (R. 6).

Simultaneously, the defendant Butterworth-Judson Co. filed its answer, wherein it (R. 17)

“admits each and every allegation contained in said bill of complaint”

It also (R. 6)

“consented in writing by its authorized attorneys to the entry of a decree appointing Receivers of all of its property, in accordance with an understanding previously had that it would do so, the creditors having determined to make an application to the Court for the appointment of Receivers.”

On the same day, the Court entered an order, in the customary comprehensive form, which, after reciting that the cause was heard upon the Bill of Complaint

“and the answer of the defendant above named consenting to this decree” (R. 17);

appointed the President, and the Comptroller of the defendant, together with a third person, as Receivers of the Butterworth-Judson Co. (R. 18),

“and of all the properties of said defendant,

real, personal and mixed of whatsoever kind and description."

The order further decreed that the Butterworth-Judson Co. (R. 18)

"deliver to the Receivers any and all properties of the defendant real, personal or mixed, in their possession or under their control"; that all persons are enjoined from disturbing the Receivers' possession or bringing suits affecting the property; that the Receivers should "have complete and exclusive control, possession and custody of all the assets and property of the defendant"; and that the Receivers should operate the property, with the usual injunction against creditors and others from suing the defendant or proceeding against its property.

The Butterworth-Judson Co., by its counsel, expressly *consented* to the entry of the decree in these words (R. 20):

"We consent to the entry of the foregoing order."

The prearranged agreement for the "*consent* receivership" is further shown by the fact that the Bill of Complaint had been verified two weeks previously, to-wit on April 6 (R. 16; see Jurat omitted from printing), while the Answer was verified on April 21, the day *before* the bill was filed (R. 17; see Jurat omitted from printing); by which the defendant *admitted in advance* the allegations of a Bill of Complaint not yet filed.

2. *The insolvency of the Butterworth-Judson Co.* The Bill of Complaint did not allege the insolvency of the Butterworth-Judson Co., but held out the possibility of its rehabilitation under a receivership, yet in point of fact (R. 6).

“On April 22, 1922, the Butterworth-Judson Corporation was insolvent, and *the aggregate of its property at a fair valuation was not sufficient to pay its debts*, and the aggregate of its property at a fair valuation *is not now* [December 17, 1924] sufficient to pay its debts, nor has such aggregate of its property been sufficient to pay its debts at any time since April 22, 1922: That on April 22, 1922, the debts of the Butterworth-Judson Corporation amounted to approximately \$3,000,000, and that at such time the aggregate of its property at a fair valuation was not in excess of \$1,500,000.”

The Receivers immediately took possession of all of the defendant’s property of every kind.

3. *The United States’ claim for priority denied.* On December 23, 1924, the United States presented its intervening petition setting up the foregoing facts, alleging that the Government had a war munition contract claim against Butterworth-Judson Co. for \$1,142,636.86—of which \$74,627.19 was undisputed, and claiming a priority of payment under R. S. §3466 (R. 2-9).

A motion to dismiss the intervening petition was granted by the District Court on the authority of *Equitable Trust Co. v. Conn. Brass & Mfg. Co.*,

290 Fed. 712 (2d CCA), upon the ground that such a "consent receivership" was neither a "voluntary assignment" nor "an act of bankruptcy" within the meaning of R. S. §3466 (R. 21-23); which ruling was affirmed *per curiam* by the Circuit Court of Appeals (R. 26).

4. *The assignments of error.* The only error assigned is the dismissal of the Government's intervening petition (R. 23).

The Latest Reorganization Device to Defeat the Government's Right of Priority Under R. S. §3466

This case turns on the proper construction and application of §3466 to the most modern scheme devised by financiers and reorganization committees, with the aid of corporation lawyers, to reorganize bankrupt corporations so as (a) to squeeze out minority creditors, (b) to avoid the prompt winding up and sale of assets with its ratable distribution of proceeds to all creditors, under the Bankruptcy Act, (c) to obtain the wide flexibility of uninterrupted operation for a long period by equity receivers under the protection of an injunction against importunate creditors, until the reorganization plans shall be consummated; and thereby (d) to defeat the United States' statutory priority and to require it to share ratably with all other unsecured creditors.

This essentially modern device was made possible by the implication in *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 381, which was formally approved in *Re Metropolitan Railway Receivership*

208 U. S. 90, 110, so that a defaulting corporation (by simply *refraining from pleading that the plaintiff had an adequate remedy at law*) could consent, over night, to a Federal equity receivership on the application of an ordinary contract creditor, before the outside creditors knew what was to be done, and whose hands would thereafter be tied by the usual injunction.

At the same time, the plaintiff, by the simple device of *alleging* that the corporation *might* be able to pay its debts under wise management—an averment so hypothetical as to be available even in the most flagrant cases of hopeless insolvency—expected to prevent any bankruptcy proceedings, on the theory that the receiver was not put in charge “*because of insolvency*” and hence was not an “*act of bankruptcy*” under the Bankruptcy Act §3 a (4).

As this modern method only arose after the decisions in the *Hollins* and *Metropolitan Receivership* cases, the question presented is whether R. S. §3466 is elastic enough to cover a situation devised to avoid it.

Therefore, it will be helpful to make a short

Review of the United States' Right of Priority Under §3466

1. At common law, by sovereign prerogative the Crown had a priority in the payment of public debts over private creditors (*Rex v. Wells*, 16 East 278; *U. S. v. State Bank of N. C.*, 6 Pet. 29, 35;

U. S. v. Canal Bank, 25 Fed. Cas. 277, 278); but the United States has no such prerogative, as there is no common law of the United States (Id). The Circuit Court of Appeals for the SECOND CIRCUIT has recently held in *Liberty Mutual Ins. Co. v. Johnson Shipyards Corp.*, 6 Fed. (2d) 752, that the United States has a prerogative of sovereignty giving it a priority for taxes regardless of any statute. This case is now here on *certiorari*, though not advanced for argument at this time.

2. To remedy that situation, at the first session of the first Congress, the Act of July 31, 1789, c 5 §21 (1 Stat. 42) was adopted, giving the United States priority in payment of certain debts in cases of insolvency; which was successively broadened by four Acts (1790-1798) cited in the margin*, so as to cover every kind of indebtedness due to the Government in cases of insolvency, absconding debtors, voluntary assignments, and acts of bankruptcy; culminating in the Act of March 2, 1799, c 22 §65, 1 Stat. 676, which continued in force for 75 years, until its re-enactment (with trifling changes designed to broaden its application) on December 1, 1873, as §3466, Rev. Stats. which is still in force.

§3466 appears as the first section of Title XXXVI of the Revised Statutes, entitled "DEBTS DUE BY OR TO THE UNITED STATES" as follows:

*Act of Aug. 4, 1790, c 35, §45, 1 Stat. 169; Act of May 2, 1792, c 27, §18, 1 Stat. 263; Act of March 3, 1797, c 20, §5, 1 Stat. 515; Act of July 11, 1798, c 71, §15, 1 Stat. 594.

"Whenever any person indebted to the United States is *insolvent*, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, *the debts due to the United States shall be first satisfied*; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a *voluntary assignment* thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an *act of bankruptcy* is committed."

3. Although the earlier acts used the phrase "in which an act of legal bankruptcy shall have been committed," it is very important to note that there was no national bankruptcy act in existence for over 90 years out of our 136 years of national life*; that the Acts of 1792, 1797 and 1799 were all passed *before* the adoption of any national bankruptcy act whatever; that there was no national bankruptcy act in existence for 63 years out of the 75 years of

*The several Bankruptcy Acts were respectively in force as follows:

Act April 4, 1800 (2 Stat. 19; repealed Dec.	
19, 1803, 2 Stat. 248).....	3 yrs.
Act Aug. 19, 1841 (5 Stat. 440; repealed	
March 3, 1843, 5 Stat. 614).....	2 yrs.
Act March 2, 1867 (14 Stat. 517; repealed	
September 1, 1878, 20 Stat. 99).....	11 yrs.
Act July 1, 1898 (30 Stat. 544).....	27 yrs.
Bankruptcy Acts in force.....	43 yrs.

life of the Act of 1799; and that R. S. §3466 was also in force for nearly 20 years when there was no national bankruptcy act.

Therefore, the term "act of bankruptcy" as used in the various priority statutes, was not limited exclusively to those technical "acts of bankruptcy" as variously defined, from time to time, in the different national bankruptcy acts. It must be given a broader meaning embracing (1) various situations which arose when there was no national bankruptcy act in force, but which Congress had in mind as constituting acts of bankruptcy in a broader and more general sense; and of course (2) any technical "act of bankruptcy" as defined in the particular Bankruptcy Act, if any, in force.

It necessarily follows from the fact that the priority statutes were in force for nearly 100 years when there were no bankruptcy acts in existence and there could not be any adjudication in bankruptcy, that it is not a condition precedent that there should be actual bankruptcy proceedings pending in order to give the United States a priority on account of the commission of some "act of bankruptcy."

In other words, there are circumstances when the United States is entitled to its priority of payment upon the commission of an "act of bankruptcy," even though there is no actual bankruptcy proceeding brought.

The exact meaning of the phrase "act of bankruptcy" as used in the priority statute, has never been defined by this Court.

By reason of the fact that (1) the language of §3466 was thus adopted and crystallized before there was any national bankruptcy act defining an "act of bankruptcy" and subsequent acts have adopted varying definitions thereof, and (2) §3466 has been equally in force whether there were or were not any national bankruptcy acts in existence, and regardless of what their particular terms were, some confusion has arisen, and different parts of §3466 have overlapped; as, for example, for over 100 years a "voluntary assignment" was not an "act of bankruptcy" even under the short lived National Bankruptcy Acts of 1800, 1841 or 1867; and it first became an "act of bankruptcy" under the Act of 1898 when it was called "a general assignment for the benefit of his creditors."

The Supreme Court's Construction of §3466

Bearing these general considerations in mind, it may be said that the Act has been authoritatively construed by this Court in the following particulars:

I. The debtor's insolvency must be such that all his property will not be sufficient to pay all his debts; (*U. S. v. Oklahoma*, 261 U. S. 253, 260 and cases there cited); but even such insolvency, taken alone, will not give to the United States a priority of payment (Id.). The insolvency must be manifested in one of the three modes pointed out in the latter part of the statute, which defines or explains the meaning of the insolvency referred to in the earlier part of the statute (Id.).

II. The Bankruptcy Act of 1867 simply reaffirmed the Act of 1797 (now §3466), and both acts made the same provision with respect to the Government's priority of payment. (*Lewis Trustee vs. U. S.*, 92 U. S. 618; *Guarantee Co. vs. Title Guaranty Co.*, 224 U. S. 152, 158.)

III. The Bankruptcy Act of 1898 did *not* reaffirm §3466, but, on the contrary, greatly modified the provisions with respect to the extent of the Government's priority of payment in bankruptcy cases (*Guarantee Co. vs. Title Guaranty Co.*, 224 U. S. 152, 158); and, in bankruptcy cases, labor claims were given priority of payment over ordinary Government debts (Id.).

IV. Under the Bankruptcy Act of 1898, the Government's claims for taxes have priority even over wages (*Oliver vs. U. S.*, 268 U. S. 1); and in bankruptcy cases the United States' priority is limited to taxes only (*Davis vs. Pringle*, 268 U. S. 315).

While the law is thus pretty well settled as to the United States' right to priority in the distribution of assets in *actual bankruptcy cases*, the law has *not* been settled by this Court in the settlement of insolvent estates *outside* of the bankrupt courts. It is with respect to this latter phase that the holdings of the various Circuit Courts of Appeals are very conflicting.

In the case at bar, a corporation is hopelessly insolvent; all of its property is wholly insufficient to

pay its debts; and the United States claims, that, under §3466, it is entitled to a priority of payment out of the assets.

Contentions of the Parties

The opposing contentions may be thus summarized:

1. The United States claims that a "consent receivership" is the equivalent of a "voluntary assignment" of all the corporation's property; *whereas*, the other creditors claim that it is not.

2. The United States claims that the appointment of the Receiver was an "act of bankruptcy"; *whereas* the other creditors claim that it was not an act of bankruptcy, because the bill in equity under which the Receivers were appointed, did not allege insolvency in the sense that the total assets were insufficient to pay the total debts, and hence the Receivers did not take charge "*because of insolvency*" [§3a (4)] within the bankruptcy meaning of the word "insolvency."

3. The United States claims that the commission of an "act of bankruptcy," to-wit; the Receivers taking charge, brought §3466 into play, and established its right of priority; *whereas* the other creditors claim that the mere commission of an "act of bankruptcy" by an insolvent debtor does not give to the United States any right of priority unless bankruptcy proceedings *are in fact instituted* and an adjudication actually had.

SUMMARY OF POINTS DISCUSSED

1. On April 22, 1922, the Butterworth-Judson Co. was insolvent in the bankruptcy sense, to-wit: the aggregate of all its property was wholly insufficient to pay its debts.

The "consent receivership" was a "voluntary assignment" of all its property.

Therefore, §3466 became operative; and the United States is entitled to priority in the payment of its debt (pp. 16-36 infra).

a. What is the proper construction of R. S. §3466 (p. 17 infra).

b. Can the Government's priority under §3466 be defeated by the device of a "consent receivership"? (p. 23 infra).

c. Differences in construction of the Bankruptcy Act and §3466 (p. 27 infra).

d. Diversity of opinion among the Circuit Court of Appeals (p. 29 infra).

2. The "consent receivership" was an "act of bankruptcy committed by the Butterworth-Judson Co.; and hence R. S. §3466 became operative and the Government was entitled to a priority of payment (pp. 36-42 infra).

FIRST POINT

1. On April 22, 1922, the Butterworth-Judson Co. was insolvent in the bankruptcy sense, to-wit: the aggregate of all its property was wholly insufficient to pay its debts;
2. The "consent receivership" was a "voluntary assignment" of all its property;
3. Therefore, §3466 became operative; and the United States is entitled to priority in the payment of its debt.

§3466 reads as follows:*

"Whenever any person indebted to the United States is insolvent, * * * the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, * * * as to cases in which an act of bankruptcy is committed."

1. *The Butterworth-Judson Co.'s insolvency.*
The Government's petition alleges (R. 6):

"That on April 22, 1922, Butterworth-Judson Corporation was *insolvent* and the *aggregate of its property at a fair valuation was not sufficient to pay its debts*, and the aggregate of its property at a fair valuation is *not now sufficient to pay its debts*, nor has such aggregate of its property been sufficient to pay its debts *at any time* since April 22, 1922.

"That on April 22, 1922, the debts of the Butterworth-Judson Corporation amounted to

*For brevity we have eliminated the provisions about deceased and absconding debtors.

approximately \$3,000,000, and that at such time the aggregate of its property at a fair valuation was not in excess of \$1,500,000."

That is admitted as true on the motion to dismiss (R. 20).

This establishes *the fact* of insolvency in the bankruptcy sense required by §3466 (*U. S. v. Oklahoma*, 261 U. S. 253, 260 and cases there cited).

2. *The "consent receivership" was a "voluntary assignment."* Is a "consent receivership" the equivalent of a "voluntary assignment" as that phrase is used in §3466? That is the question on which the Circuit Courts of Appeals are squarely divided. (See analysis of their opinions, p. 29 *infra*).

What is the proper construction of R. S. §3466?

When the original priority statutes were adopted in 1789-1799 (the language of which has been substantially followed in §3466) Congress gave to the United States a privilege equivalent to the prerogative of the Crown, *to-wit*: that debts due to the United States should be first paid, in the following cases, where the debtor was insolvent (in the bankruptcy sense that all of his property was insufficient to pay all his debts), *to-wit*;

1. When the debtor died.
2. When the debtor absconded, concealed himself or was absent and his property was attached by law.
3. When the debtor committed an "act of bank-

ruptcy" rendering his property subject to involuntary seizure under existing, or future bankruptcy laws.

4. When the debtor made a voluntary assignment of all of his property, by which he was divested of its possession and control.

Such is the effect of the decisions of this Court construing the priority statutes.*

In *U. S. v. The State Bank of North Carolina*, 6 Pet. 29, Mr. Justice Story thus spoke of the priority statute:

"The right of priority of payment of debts due to the government, is a prerogative of the Crown well known to the common law. It is founded not so much upon any personal advantage to the sovereign, as upon motives of public policy, in order to secure an adequate revenue to sustain the public burdens and discharge the public debts.

"The claim of the United States, however, *does not stand upon any sovereign prerogative*, but is exclusively founded upon the *actual provisions of their own statutes*. *The same policy, which governed in the case of the royal prerogative, may be clearly traced in these statutes*; and as that policy has mainly a reference to the public good, *there is no reason for giving to them a strict and narrow interpretation*. Like all other statutes of this nature, they ought to receive a *fair and reasonable interpretation*, according to the just import of their terms."

*The cases (1) and (2) *supra* to-wit, decedents, absconding, concealed and absent debtors, may be disregarded as irrelevant in the present discussion.

What Congress had in mind was to secure a priority of payment, (a) when an insolvent debtor's property was subject to *involuntary seizure* under the bankruptcy laws, or (b) when the debtor *voluntarily assigned* it to another.

Bearing these considerations in mind, the question arises whether the term "voluntary assignment" (1) must be limited to the execution of an *instrument* in the nature of a bill of sale or deed signed and delivered by an assignor to an assignee transferring and conveying property, or (2) whether it includes, not only the *instrument*, but also the *act* of assignment, by whatever means accomplished.

The term "voluntary assignment" denotes, not only the *instrument* by which property is conveyed, but also the *act* of transfer; and in these different senses i. e. means and results, it is variously applied in law (Burrill on Assignments, 6th Ed. §1).

If the phrase "voluntary assignment" is to be restricted to the execution of a formal *instrument* by an assignor to an assignee, of course the Government's claim fails, as there was no such formal instrument executed by the Butterworth-Judson Co. to the receivers.

On the other hand, if the phrase "voluntary assignment" includes the *act*, as well as the *instrument*, then the question presented is whether a "consent receivership" is or is not a "voluntary assignment."

For example, by Ky. Stat. §1910 a judgment suffered, or any act or device done in contemplation of insolvency, with the design to prefer one creditor over another, becomes *ipso facto*, by operation of law, a general assignment for the benefit of creditors. That is an illustration of where a general assignment comes into existence *without* the execution of any formal *instrument* assigning, transferring or conveying title. So here, the priority statute embraces any *transaction*, which is in essence and effect a "voluntary assignment" of all the property of an insolvent debtor.

For instance, if a debtor, insolvent in the bankruptcy sense, should, in Kentucky, by agreement with some of his creditors, leave the county of his residence and return again secretly in order to have process in actions in their favor executed, and then leave the county, such an act would operate as a general assignment for the benefit of creditors (*Wilson v. Snelling*, 3 Bush. 322). In such a case, when all the property of the debtor was being administered in an equity suit for the settlement of such assigned estate, could the Government's claim for priority be denied, on the ground that the debtor had not made a "voluntary assignment" of his property, although a general assignment had been made, by operation of law, as a result of his voluntary act in preferring one creditor over another? Many similar situations can be imagined and found in the reported cases.

There are many cases where transactions have been held to the general assignments without the execution of a formal instrument (*In re Green*, 106 Fed. 313; *Moody v. Clinton Wire Cloth Co.*, 246 Fed. 653; *In re Hersey*, 171 Fed. 998; *In re Salmon v. Salmon*, 143 Fed. 395; *Gill v. Farmers Bank*, 189 Mo. App. 401. These acts were as technically different from a general assignment as a consent receivership is. ✓

A. The Butterworth-Judson Co.'s action was certainly *voluntary*, in every possible sense of the word.

Before the bill was filed, the Butterworth-Judson Co. *consented thereto, and agreed with the plaintiff that it would consent to the filing of the bill and to the appointment of a receiver* (R. 6); it signed and verified the answer *before* the bill was filed (R. 17); it consented to the filing of the bill (R. 6); it simultaneously filed an answer *admitting* every allegation of the bill, *including the untrue averment* that the plaintiff "has no adequate remedy at law, but can have relief only in equity" (R. 14); it *consented in writing* to the entry of a decree appointing receivers of all its property (R. 6, 17, 20), —all in accordance with a *previous understanding* that it would do so (R. 6). No receiver could have been appointed at the instance of a simple contract creditor (*Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 379). All that the Butterworth-Judson Co. had to do, in order to secure a dismissal of the bill and to prevent the receivership, was to move to dismiss on the ground that the plaintiff had an ade-

quate remedy at law. (Id.; *American Mills Co. v. American Surety Co.*, 260 U. S. 360, 363.)

Instead of resisting the effort to transfer all of its property to receivers for application and distribution to the claims of creditors, the Butterworth-Judson Co. *voluntarily waived* its right to object, *affirmatively consented* to the receivership, and thereby *voluntarily enabled* the receivers to be appointed, without which acquiescence no court could or would have appointed them.

This certainly establishes the "*voluntary*" nature of what was done.

B. The appointment of the receivers certainly *divested* the Butterworth-Judson Co. from the possession and control of all its property.

The order appointing the receivers adjudged that the receivers *should receive*, and that the defendant *should deliver* to the receivers, *any and all properties of the defendant, real, personal and mixed of whatsoever kind and wheresoever situated*; and all persons, including the defendants, were enjoined from interfering in any way with the receivers' possession, control, and operation thereof (R. 18-20). The effect of such a receivership was just as complete a divestiture by the Butterworth-Judson Co. of all of its property, as the most formal possible voluntary written instrument of assignment could have accomplished—indeed much more so, since the receivership contained an injunction preventing the defendant, or anyone else, from interfering with such new possession, whereas, in the case of an assignment, the assignor and the assignee, by

agreement, might have returned the property to the assignor without being subject to contempt of court.*

Can the Government's priority under
§3466 be defeated by the modern device
of a "consent receivership"?

The modern "consent receivership" is the plan by which bank creditors and a failing corporation usually co-operate to accomplish the following results, which results could not be accomplished except by such co-operation and the *voluntary consent* of the debtor.

FIRST: *Avoidance of bankruptcy proceedings*; because in bankruptcy the bankrupt's business must be promptly wound up, the assets sold and distribution made to the creditors under the priorities prescribed by §64b (*Wiswall v. Campbell*, 93 U. S. 347, 350).

N. B. The re-organization managers avoid bankruptcy by taking care that the debtor does not pay any past due debts or commit any other act of bankruptcy within the statutory period before the receivership.

*The *dictum* in *Beaston v. Farmers Bank*, 12 Peters, 102 to the effect that the appointment of certain receivers did not operate as a voluntary assignment under the priority statute, is not in point, because the receivers there were appointed under a creditors' bill on a return of *nulla bona*, and hence there was no element of *voluntary consent* to their appointment, nor indeed did the receivers ever take charge of the property, nor was the debtor insolvent in the bankruptcy sense, nor did the trustees, appointed by the debtor, ever act.

SECOND: *Secure the benefit of an equity receivership;* under which there can be the broadest and most flexible operation of the business as a going concern, absolutely free from harassment or annoyance from creditors seeking to collect their debts.

N. B. This is accomplished by agreement between the bankrupt and one creditor, who brings a suit and alleges that the bankrupt, while financially embarrassed, is really solvent, and gets a receiver appointed by the *consent* of the bankrupt, who waives the defense of an adequate remedy at law. This procedure can be taken over night, as there is no preliminary warning to the creditors generally by a suit, judgment and a return of *nulla bona*, so that outside creditors have no opportunity to know what is going on.

In order to prevent the operation of the Bankruptcy Act, as amended in 1903, which makes the appointment of a receiver "*because of insolvency*" an "*act of bankruptcy*," the simple device is used of affirmatively alleging in the bill either that the defendant is solvent or that he may be able to pay out by the aid of a receivership, which will prevent harassment and preserve the business as a going concern; these allegations are made in case after case of known hopeless insolvency in the bankruptcy sense, and the debtor answers admitting *solvency*, when he knows it is untrue.

THIRD: *A protective bankruptcy proceeding:* Frequently the reorganization managers, by agree-

ment with the insolvent debtor, file a friendly bankruptcy petition; and then by repeated agreements with the bankrupt, postpone the time for answering and thus prevent an adjudication. This arrangement deters other creditors from filing bankruptcy proceedings as they realize that the prior proceeding can, at any moment, be pressed and the control of the litigation kept out of their own hands. It is a commonplace of corporate practice that an equity receivership, combined with a protective bankruptcy, enables a reorganization committee to delay indefinitely non-assenting creditors, to operate the property as a going concern, and to take their own time about the reorganization. This can only be done, however, when there is *complete agreement* between certain creditors and the insolvent debtor.

All this goes to show that the "consent receivership" is a "*voluntary assignment*" and also an "*act of bankruptcy*" which it is attempted to camouflage, in order to prevent winding up in bankruptcy.

THE EFFECT ON THE GOVERNMENT'S RIGHT OF PRIORITY

The Government is the one creditor who suffers by this arrangement as it gets neither (1) its priority for taxes in the bankruptcy proceedings nor (2) its priority under §3466. By this plan, suits, executions, attachments, etc., against the debtor are avoided, bankruptcy is avoided, creditors' hands are tied, the debtor is relieved from pressure to make a deed of assignment, and the following is the effect upon the claims of the United States.

(a) By avoiding bankruptcy, the United States does not get even the priority for taxes allowed under the Bankruptcy Act (*Oliver v. U. S.*, 268 U. S. 1; *Davis v. Pringle*, 268, U. S. 315).*

(b) The United States, thus defeated of its limited priority under the Bankruptcy Act, is likewise deprived of its priority under §3466, because it is claimed, as here, (1) that there has been no "voluntary assignment"; (2) that no act of bankruptcy has been committed, because the receivers were not appointed "because of insolvency," but merely *by consent*, in order to preserve the business as a going concern; and (3) that even if the receivership be deemed an "act of bankruptcy," §3466 did not become operative because no bankruptcy proceedings were *in fact* instituted.

(c) The result is, that, although the debtor is *in fact* insolvent in the bankruptcy sense; although he has been divested of all of his property which has been taken over by the receivers for distribution among his creditors under the orders of the court, and although a receiver has been appointed when the bankrupt *is in fact insolvent* (although the bill may falsely indicate only financial embarrassment), the United States is deprived of all priority unless the Government's contention be sustained in the *Johnson Shipyards Corp.* case (No. 496, October Term,

*Even labor claims, otherwise entitled to preference under the Bankruptcy Act (*Guarantee Co. v. Title Guaranty Co.*, 224 U. S. 152), are reduced to the level of other unsecured claims.

1925), submitted with this case, that taxes have priority in any event. Nothing in this Brief is intended to waive the Government's contentions in that case.

Therefore, general creditors of an insolvent debtor, by agreement with his creditors, can completely defeat the Government's statutory priority by the simple device of co-operation with the debtor. The essential elements of co-operation which are (a) preparation of a bill in equity for a receiver, but alleging financial embarrassment instead of insolvency; (b) consent of the debtor to the arrangement; (c) agreed pleadings and decree appointing a receiver and (d) operation under the receivership until the parties have perfected their plans—when the company will be reorganized, the assets sold and purchased by a new corporation owned by the co-operating creditors and the bankrupt, while the United States' priority is entirely defeated.

Even the Circuit Court of Appeals for the SECOND CIRCUIT, which led the way in the *Conn. Brass Co.* case (290 Fed. 712) in sustaining the "consent receivership" plan for defeating the United States' right of priority, has very recently shrunk from the logical consequences of its decision; and, in order to give some relief to the Government, has decided that *taxes* are *not* debts; and that by sovereign prerogative, the United States has a priority for taxes (*Liberty Mutual Ins. Co. v. Johnson Shipyards Corp.*, 6 Fed. (2d) 752). It signifies a decided qualification of its earlier position.

It should be borne in mind that there is quite a

difference in the construction which should be given to the Bankruptcy Act and §3466, respectively.

BANKRUPTCY ACT. Under the original Bankruptcy Act of 1898, a general assignment was an "act of bankruptcy," even if the debtor was *solvent*. Therefore, if a "consent receivership" had been held equivalent to a general assignment, such "consent receivership" would have been an act of bankruptcy, though the debtor were perfectly *solvent*, but only temporarily embarrassed; and *solvent* concerns could have been thrown into bankruptcy and wound up.

Such a construction of the Bankruptcy Act would have stopped all consent receiverships, and the courts frequently held that as the Bankruptcy Act was passed for the *benefit of debtors*, and was in derogation of the common law, it should be *strictly* construed and that "consent receiverships" were *not* equivalent to a general assignment, and hence not acts of bankruptcy.

PRIORITY STATUTE. On the other hand, the priority statute was based on public policy, was declaratory of the common law, and was passed for the benefit of the United States. It should be *liberally* construed. (*United States v. State Bank of North Carolina*, 6 Peters 29.)

Under §3466 it is necessary, not only that there should be a "voluntary assignment," i. e., a consent receivership, but there must be also *insolvency* in the bankruptcy sense. The courts should give a *liberal* construction to the phrase "voluntary assignment," so as to hold that a "consent receivership" is the equivalent to a "voluntary assignment."

Diversity of Opinion Among the Circuit Courts of Appeals

1. *The Circuit Courts of Appeals of the First, Fifth and Ninth Circuits hold that a "consent receivership" is the equivalent of a "voluntary assignment"; and the Fifth and Ninth Circuits hold that it also constitutes an "act of bankruptcy."*

In *Davis v. Pullen*, 277 Fed. 650 (1922) there was a "consent receiver" appointed under a bill alleging solvency, when, in fact, as here, the company was insolvent in the bankruptcy sense (p. 651). The FIRST CIRCUIT held (1) that as the first priority statute was adopted *before* there was any national bankruptcy act, it was not necessary that actual bankruptcy proceedings be instituted in order to give the Government a priority; (2) that a consent receivership was a "voluntary assignment" within §3466; and (3) the United States was entitled to priority in the payment of freight bills due the Director General, saying (p. 651):

"Certainly, when a debtor has assented to the appointment of a receiver on a bill which prays that its debts may be established and ordered to be paid out of its assets, and when, on marshaling assets and liabilities, it appears that such debtor is and was at the beginning of the proceedings hopelessly insolvent, it would seem plain that such insolvency was sufficiently notorious to bring the case within the fair meaning of the words bankruptcy and insolvency as

used when the priority statute was enacted [citation omitted].

"There is no doubt that the assets of this corporation, now in *custodia legis*, are being distributed to its creditors because it is in fact insolvent, and because the proceedings by which it was dispossessed of its property were *assented to*, if not indirectly invoked, by it.

"Of course, if it had turned out to be in fact solvent, as it was alleged to be, no question of priority would have arisen. Under such circumstances, the distinction between bankruptcy and insolvency or assignments for the benefit of creditors, on the one side, and equity receivership proceedings on the other side, is for present purposes, apparently immaterial."

In *Davis v. Miller-Link Lumber Co.*, 296 Fed. 649 (1924) the FIFTH CIRCUIT, under similar circumstances as to a "consent receivership," held the same way, saying (p. 652),

"An insolvent debtor, *by procuring or assenting to the appointment of a receiver of all his property under such an order as the one made in the instant case, does an act which under the circumstances is reasonably to be expected to have substantially the same result as the making by him of a general assignment for the benefit of his creditors, namely, the divesting of his title to such property, the application of it or the proceeds of the sale of it to the payment of his debts, and the settlement and winding up of his estate.*

"A general assignment by a debtor for the benefit of his creditors, within the meaning of

subdivision 4 of amended section 3a of the Bankruptcy Act (Comp. St. §9587), embraces any act by the debtor having the effect of a conveyance of all his property and an appropriation of it to raise funds to pay his debts, share and share alike, and a debtor's participation in bringing about the appointment of a receiver of all his property may be under such circumstances as to have that effect. *Moody-Hermann-Boelhauwe v. Clinton Wire Cloth Co.*, 246 Fed. 653, 158 C. C. A. 159.

"For reasons above indicated, we conclude that the appointment of receivers now in question was made under such circumstances as to have the effect of a general assignment by the debtor for the benefit of its creditors, with the result of making the receivers holders of the debtor's property as trustees for its creditors, and bound to pay the debt due to the United States first out of the proceeds of such property. A similar conclusion on a quite similar state of facts was reached in the case of *Davis v. Pullen* (C. C. A.) 277 Fed. 650."

In *Bramwell v. U. S. F. & G. Co.*, 299 Fed. 705 (1924) a bank, being hopelessly insolvent, *voluntarily* turned over all its assets to the State Superintendent of Banks for liquidation and distribution among its creditors. The NINTH CIRCUIT held that a surety (being subrogated to the United States' rights) was entitled to priority of payment (on two grounds, to-wit: (1) that a "voluntary assignment" had been made and (2) that an "act of bankruptcy" had been committed, even though no bankruptcy proceedings had ensued.

It distinguished the facts from those existing in *U. S. v. Oklahoma*, 261 U. S. 253; and said:

"The directors *voluntarily* placed the Bank in the hands of the Superintendent of Banks and *surrendered* to him *possession* of all the assets thereof *for the purpose of liquidation* * * * in the case at bar there was first insolvency as defined by §3466, and the resolution of the board of directors was, we think, tantamount to a voluntary and general assignment within the meaning of the National Bankruptcy Act. Thereby the affairs of the bank passed absolutely out of the control of its officers and into the control of an officer whose duty was to liquidate the bank's business and distribute its assets among its creditors and depositors. * * *

"What was there said, however, does not negative the fact that the possession and control of the bank officers over the assets of the bank were as completely divested by their resolution and as completely vested in the superintendent of banks as they could be by any conceivable assignment for the benefit of creditors, and that the title to the assets, although it might be in abeyance until a sale by the superintendent of banks, could not possibly, under the facts in the case, ever be restored to the corporation, but must inevitably be divested in carrying out the purpose of the resolution. * * *

"We think it should be held that the voluntary transfer of the bank and its property to the Superintendent of banks and the submission thereof to his administration in liquidation and disposition of the proceeds, was in substance putting a 'Receiver or Trustee' in

charge of the bank's property under the law of the State and within the meaning of the Bankruptcy Act."

To the same effect see *U. S. v. Parker* (D. C. Wis.) not yet reported.

2. *The Circuit Courts of Appeals of the Second and Sixth Circuits hold that a "consent receivership" is not the equivalent of a "voluntary assignment" under §3466;*

In *Equitable Trust Co. v. Conn. Brass & Mfg. Co.*, 290 Fed. 712, (1923) there was a "consent receivership," under allegations of solvency but mismanagement, and the United States intervened, claiming priority for certain war contract debts. After reviewing the history of the priority statutes and various cases arising under them, the SECOND CIRCUIT held that a "consent receivership" was not the equivalent of a voluntary assignment, and denied the Government's priority, saying (p. 723):

"We think the decisions of the Supreme Court, extending over a period of more than 100 years, have clearly established the law that the right of the United States to priority of payment is statutory, and does not apply while the debtor continues the owner of the property, even though he is unable to pay his debts. No evidence can be received of the insolvency of a living debtor until he has been divested of his property by making a voluntary assignment thereof, or has committed an act of bankruptcy, or his effects have been attached by process of

law on the ground that he is an absconding, concealed, or absent debtor."

In *Davis v. Michigan Trust Co.*, 2 Fed. (2d) 194 (1924) there was again the typical "consent receivership," with allegations of solvency, when the company was in fact hopelessly insolvent in the bankruptcy sense. The SIXTH CIRCUIT followed the SECOND CIRCUIT's holding in the *Conn. Brass Co.* case; but the opinion is apparently even more adverse to the Government, in that it seems to limit the priority to cases (1) where the State seizes the property, or (2) where actual bankruptcy proceedings are had (p. 196 [1]); and would seem to deny priority under §3466 even in the case where a *formal voluntary assignment* for the benefit of creditors is made, *unless* actually followed by bankruptcy proceedings. If that latter intimation is correct, then as the Government's right of priority is limited to taxes only (*Davis v. Pringle*, 268 U. S. 315); and as that much is given by the Bankruptcy Act itself (*Oliver v. U. S.*, 268 U. S. 1), the result is that §3466 is *repealed* except in the unusual cases of deceased or absconding debtors, or of a State seizing a debtor's property.

It is very easy to show the unsoundness of the view that, in order to give the Government priority under §3466 where an act of bankruptcy has been committed, it is necessary for such act to be followed by the *institution* of bankruptcy proceedings.

If such a contention were correct, it would simply mean that the last clause of §3466 was and always had been utterly meaningless.

(a) If actual bankruptcy proceedings are necessary, then as §3466 existed *before* the Bankruptcy Act of 1898, §3466 could not have given the Government priority in case of an "act of bankruptcy" in, for example, 1890, when there was no Bankruptcy Act in force. Hence, the Government could not have had any priority when an act of bankruptcy was committed. The same thing would have been true in 1790, or from 1804 to 1840, from 1845 to 1865, from 1880 to 1897, so the words "act of bankruptcy" were simply meaningless.

(b) The words would have been equally meaningless under the Bankruptcy Act of 1867; because it provides that the Government should have priority for *all* its debts; and, *ipso facto*, upon an adjudication in bankruptcy in 1867-1878, the Government's priority was complete under the Act of 1867 without any aid from §3466, which would have been no assistance while the Act of 1867 was in force (*Lewis Trustee vs. U. S.*, 92 U. S. 618).

(c) Under the Bankruptcy Act of 1898 the words would be equally meaningless because the Government's priority is limited to taxes alone (*Davis v. Pringle*, 268 U. S. 315), which priority it is entitled to without the slightest regard to §3466 (*Oliver vs. U. S.*, 268 U. S. 1). *Davis v. Pringle* held in effect that the Bankruptcy Act of 1898 repealed §3466 so far as Bankruptcy proceedings are concerned.

The result of this analysis is, that, if the Circuit Court of Appeals is correct in holding that the Government can *only* claim priority under §3466, on

account of the commission of an "act of bankruptcy," when such act is followed by the institution of bankruptcy proceedings, then, and in such event, §3466 has no effect whatever, as the Bankruptcy Act controls; and the Government could have the benefit of the Bankruptcy Act without regard to the existence of §3466. Such a construction would make §3466 a perfectly meaningless statute—a *reductio ad absurdum*.

SECOND POINT

The "consent receivership" was an "act of bankruptcy" committed by the Butterworth-Judson Co.; and hence R. S. §3466 became operative and the Government was entitled to a priority of payment.

§3466 provides that the Government's priority shall extend to "cases in which an act of bankruptcy is committed."

As there was no National Bankruptcy Act in existence during the years 1790-1799, the repeated use of the phrase "act of bankruptcy" or "act of legal bankruptcy" in these priority statutes, referred, not to acts of bankruptcy under the English law (*Conrad v. Nicoll* 4 Pet. 291, 307: 1 Kent Com. 343 note 1), but to acts of bankruptcy under the then existing State statutes, or under any future bankruptcy laws that might be passed by Congress. (Id.: *Davis v. Michigan Trust Co.*, 2 Fed. (2d) 194, 197.)

Without stopping to inquire what the phrase "act of bankruptcy" meant during the 90 years when there was no Federal bankruptcy act in existence, we will limit our discussion to the present time,

when the Bankruptcy Act of 1898 specifically defines what is meant by an "act of bankruptcy."

Under the original Bankruptcy Act of 1898, there was no provision by which the appointment of a receiver for a debtor could be considered an "act of bankruptcy." Accordingly, creditors and debtors alike, who did not wish the administration of an insolvent estate to be conducted by the bankrupt courts, quickly learned to have equity receivers appointed. Some Courts declined to construe these equity receiverships as the equivalent of a general assignment for the benefit of creditors; and so the bankruptcy courts were often evaded.

To remedy that situation, Congress amended the Bankruptcy Act by the amendment of 1903 (32 Stat. 797) by adding to §3a (4) a provision that an act of bankruptcy should consist of a person having,

"being insolvent, applied for a Receiver or Trustee for his property, or because of insolvency, a Receiver or Trustee has been put in charge of his property under the laws of a State, of a territory, or of the United States."

I.

With the aid of lawyers, and the doctrine of *Re Metropolitan Railway Receivership*, 208 U. S. 90, decided a few years later, banking creditors invented a new plan to avoid the bankruptcy courts. As already explained (p. *supra*) the method adopted

was this: A simple contract creditor would file a bill for a receiver; instead of alleging insolvency—no matter how insolvent the debtor might be—the creditor would allege that the debtor was unable to pay his debts, but that if a receiver were appointed his property would be preserved and might produce a larger sum for the creditors than it otherwise would produce; the debtor would then waive the objection of an adequate remedy at law, consent to the receivership, and receivers would be appointed to take charge of the debtor's property.

If the transaction were assailed as the commission of an "act of bankruptcy," it was argued,

First: That the Receiver had not been appointed "because of insolvency," but because of a desire to conserve the property; and although in such cases it nearly always developed that the debtor was in fact insolvent in the bankruptcy sense, nevertheless it was claimed that there had not been any "act of bankruptcy"; and

Second: That, even in those cases where the application for a receiver disclosed insolvency in the bankruptcy sense, but no creditor chose to take advantage of the act of bankruptcy and file a petition in bankruptcy, and the receivership was allowed to continue, the United States could not claim in the receivership suit, any priority under §3466, because no *bankruptcy* proceedings had been *actually instituted*; the contention being that in order for §3466 to become operative, there must be not only an act

of bankruptcy, but it must be *followed up* by actual bankruptcy proceedings based on such act.

As a matter of public policy, Congress adopted §3466, declaring that Government debts should be first paid. The statute accomplishing that result should be given a construction sufficiently elastic to cover the various devices resorted to by creditors in the effort to prevent the Government from receiving its priority.

Congress cannot change its laws every time that persons subject thereto, seek, by co-operation, to avoid the effect of the statute by just enough change in form to avoid the strict letter of the law.

The operation of §3466 is certainly defeated, if a debtor, insolvent in the bankruptcy sense, can, by agreement with a creditor, have the creditor file a suit for a receiver, with an allegation of a lesser kind of insolvency, obtain the appointment of a receiver by consent and then successfully claim that no act of bankruptcy has been committed—when the *only reason* for the receivership was that the debtor was *actually insolvent* in the bankruptcy sense.

At last, the question presented is whether the Government's priority under §3466 can be defeated by an agreement, between a creditor and a debtor, to call the debtor's financial condition one thing when the receiver is appointed, *whereas*, in point of fact, the debtor's condition is something very different; and if that different condition had been truthfully

alleged, it would have been an act of bankruptcy and §3466 would have come into play.

In other words, can a debtor and his creditor, by calling something a false name, defeat the Government's priority; and in this manner, obtain by such false name, all the advantages that would have been obtained by giving the true name, and yet avoid the disadvantages that would result from giving the true name?

On April 22, 1922, the Butterworth-Judson Co. was insolvent. If a Receiver had been appointed *on the ground of insolvency*, it would have been an "act of bankruptcy" and the Government's priority under §3466 would have been established.

Can the Government be denied that priority simply because the parties, *by agreement*, alleged financial embarrassment, when in fact the Company was insolvent, and thus obtained the benefit of the same receivership which they would have gotten if they had alleged insolvency? Indeed, the later authorities hold that if a receiver is appointed upon the ground that the debtor is simply unable to pay his debts in the ordinary course of business, when it later develops that the debtor was in fact then insolvent in the bankruptcy sense, such appointment constitutes an "act of bankruptcy" (*Hilb v. Am. Smelting & Refining Co.*, 235 Fed. 384; *Re Sedalia Farmers Produce Co.*, 268 Fed. 898; *Davis v. Michigan Trust Co.*, 2 Fed. (2d) 194).

The theory of those cases is that if it subsequently develops that, at the time of the application for a receiver, the debtor *was insolvent* in the bankruptcy sense, then it was *insolvency*, whether recognized at the time or not, which brought about the receivership.

The question, then, which this Court must determine, is whether it is, or is not, an "act of bankruptcy" within §3466, for a creditor and a debtor by mutual agreement, to have a receiver put in charge of the debtor's property when the debtor is in fact insolvent in the bankruptcy sense, although by such agreement the creditor in his bill for the receiver did not allege insolvency in the bankruptcy sense.

II.

The Bankruptcy Act provides that an "act of bankruptcy" by any person shall consist of his having "being insolvent, *applied* for a receiver or trustee for his property."

Although the Butterworth-Judson Co. did not, in one sense, apply for a Receiver, yet, in substance, *that is exactly what it did.*

The Butterworth-Judson Co. was insolvent in the bankruptcy sense; and while thus insolvent, it, by pre-arrangement with the creditor, procured the filing of a bill in equity, *consented* to the filing of the bill, *admitted* its allegations, *waived* a complete defense which it had to the bill, and then *consented* to

the entry of a decree appointing receivers for itself —all in accordance with a *prior agreement* with its creditors.

If that does not constitute *applying* for a receiver, it is because only the form, and not the substance, is taken into account. The real effect of such a transaction is that a creditor and a debtor *joined in an application* to the court for a receiver, when the debtor was insolvent.

The Court would never have appointed the receivers, if the debtor had objected on the ground that the creditor had an adequate remedy at law. It was only by the *affirmative co-operation* of plaintiff and defendant, *jointly* requesting a receiver, that the court appointed a receiver.

It is submitted that under such a state of case the debtor "being insolvent, applied for a receiver for his property" (1st Remington on Bankruptcy, 3d Ed. §159).

The decree should be reversed.

WILLIAM D. MITCHELL,
Solicitor General.

WM. MARSHALL BULLITT,
Special Assistant to the
Attorney General.

November 11, 1925.

FILED

MAY 28 1925

WM. H. STANSB
CLE

No. 503

IN THE

Supreme Court of the United States

OCTOBER TERM, 1925 1925

UNITED STATES OF AMERICA,
Petitioner,
against

BUTTERWORTH-JUDSON CORPORATION, *et al.*,
Respondents.

BRIEF OF RECEIVERS OF BUTTERWORTH-JUDSON CORPORATION, RESPONDENTS, IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

RUSHMORE, BISBEE & STERN,
Solicitors for Receivers,
61 Broadway,
New York.

ELDON BISBEE,
BERTRAM F. SHIPMAN,
Of Counsel.



No.

IN THE

Supreme Court of the United States

OCTOBER TERM—1924.

UNITED STATES OF AMERICA,
Petitioner,
against
BUTTERWORTH-JUDSON CORPORA-
TION, *et al.*,
Respondents.

**BRIEF OF RECEIVERS OF BUTTERWORTH-JUD-
SON CORPORATION, RESPONDENTS, IN
OPPOSITION TO PETITION FOR A
WRIT OF CERTIORARI.**

The Receivers of Butterworth-Judson Corporation, Respondents, submit that the petition for a writ of certiorari should be denied because both courts below in denying the claim of the United States to priority over general creditors in payment of its contract claims followed implicitly the interpretation which this Court has placed upon Section 3466 Revised Statutes and identical predecessor statutes in an unbroken line of decisions dating from the earliest days of the Government to *United States vs. Oklahoma*, 261 U. S. 253. In its last statement of the statutory rule of priority this Court said:

*** Mere inability of the debtor to pay all his debts in the ordinary course of business is not insolvency within the meaning of the act, but it must be manifested in one of the modes pointed out in the latter part of the statute which defines or explains the meaning of insolvency referred to in the earlier part ***.

*** In order to give the priority specified in Section 3466, there must be a case of an insolvent debtor who makes a voluntary assignment of his property, or a case in which the estate and effects of an absconding, concealed or absent debtor are attached by process of law, or a case in which an act of bankruptcy is committed. *** (261 U. S. 253, 260, 262).

Both the Circuit Court of Appeals and the District Court, giving full effect to Section 3466 and the decisions of this Court, held that notwithstanding that it now appears that at the time of the appointment of the Receivers, Butterworth-Judson Corporation was insolvent in the bankruptcy sense, such insolvency has not been manifested in one of the modes required by the statute: that is, the corporation had not made a voluntary assignment of its property nor committed an act of bankruptcy.

The United States contended that the appointment of receivers under the circumstances of this case in effect constituted an act of bankruptcy or an assignment of all its property. The facts relating to the appointment of the receivers are set forth in the petition of the United States for priority (Record, p. 3) and the exhibits thereto, the issue having arisen on motions to dismiss the petition. The facts are also summarized in the brief filed by the receivers in the court below,

copies of which they beg leave to submit with this memorandum.

In its petition for certiorari the United States alleges (p. 2) that the Corporation "made an arrangement in advance with its creditors for one general creditor to bring a suit against it for an equity receivership" as supporting the conclusion that the Corporation "in effect, while insolvent, applied for the appointment of a receiver for all of its property and made an assignment thereof." This premise of fact is wholly without support in the record. The petition alleged (Record, p. 12):

"Seventeenth: That as a result of the actions and proceedings of creditors as herein set forth, and of the failure and inability of Butterworth-Judson Corporation aided by its creditors to effect payment of its liabilities and the satisfaction, discharge or vacating of said MacKellar judgment, Hay Foundry & Iron Works, Inc., the complainant herein, a simple contract creditor, on April 22, 1922, filed its Bill of Complaint herein for the appointment of Receivers for the protection of creditors of Butterworth-Judson Corporation, all with the full knowledge and consent of Butterworth-Judson Corporation, which on the said 22nd day of April, 1922, by its duly authorized attorneys, appeared, answered as hereinbefore set forth in paragraph Fourth of this petition and submitted its rights in the premises to the protection of the Court; and consented in writing by its authorized attorneys to the entry of a decree appointing Receivers of all of its property, *in accordance with an understanding previously had that it would do so, the creditors having determined to make an application to the Court for the appointment of receivers.*"

The fact is that there is nothing collusive in the situation, the case being the usual one of equity receivers appointed in a creditor's suit, and the only question involved in the light of the decisions of this Court is whether the corporation had committed an act of bankruptcy, the voluntary assignment under Section 3466 Revised Statutes being identical with general assignment for the benefit of creditors in the Bankruptcy Act.

The District Court held (Record, p. 48) that no act of bankruptcy was committed because

- (a) the receivers were not appointed because of insolvency;
- (b) the Corporation did not apply for the appointment of receivers; and
- (c) the Corporation did not make a general assignment for the benefit of creditors or a voluntary assignment of its property.

These points are argued in the accompanying brief and are sustained by abundance of authority.

The United States relies upon cases from the First, Fifth and Sixth Circuit Courts of Appeals as being in conflict with the decision in this case and *Davis v. Michigan Trust Co.*, 2 Fed. (2nd) 194.

In *Davis v. Pullen*, 277 Fed. 650 (1st C. C. A.), the Court was of the opinion that as there were no bankruptcy acts at the time the first priority statutes were enacted, "we are necessitated to put some sensible construction upon the words 'insolvent' and 'bankruptcy' as used in the statute." This argument had long since been anticipated and answered by this Court in *Prince v. Bartlett*, 8 Cranch. 431, by pointing out that there

were then in existence State insolvency and bankruptcy acts, and that the words "insolvency" and "bankruptcy" in the Act of 1790 appeared to have been used as synonymous terms. Moreover *Davis v. Pullen* was decided before *United States v. Oklahoma*, 261 U. S. 253, which further demonstrates the unsoundness of the argument advanced in the First Circuit case.

In *Davis v. Miller-Link Lumber Co.*, 296 Fed. 649, (5th C. C. A.), the corporation joined in the application for the appointment of the receivers; and in *Bramwell v. United States Fidelity & Guaranty Co.*, 299 Fed. 705, (9th C. C. A.), the debtor bank voluntarily by resolution of its directors surrendered all of its assets to the State Superintendent of Banks for the purpose of liquidation under State statutes. While language employed in the two cases is in conflict with the decision in this case and the decision in *Davis v. Michigan Trust Co. (supra)*, they are clearly distinguishable in fact. We are not advised of the grounds urged by the Director General in his application for a writ of certiorari in *Davis v. Michigan Trust Co.*, but it is not improbable in view of the state of the authorities that this Court granted the writ in order to review the question of the right of the Director-General to assert the Government's priority—a right which was denied by the court in that case.

Confidently asserting that this case was correctly decided by the courts below, we suggest that it will be a hardship to the creditors of the corporation to be submitted to the delay and expense involved in a further hearing. The receivership has now lasted more than three years;

the corporation's assets have been liquidated and even if the Government is not entitled to priority, the creditors will receive only a small dividend on their claims. Distribution awaits only a determination of the Government's claim and issues connected therewith. The settlement of the priority question will in all probability make possible a prompt adjustment of other questions and permit a final distribution.

For the foregoing reasons, it is submitted that the petition for a writ of certiorari should be denied.

If it be granted, the respondents join in the motion of the United States that the case be advanced and assigned for oral argument on November 2, 1925, but as the case differs materially from *Bramwell v. United States Fidelity & Guaranty Co.*, request that it be assigned for argument preceding or following that case.

RUSHMORE, BISBEE & STERN,
Solicitors for Receivers of
Butterworth-Judson Corporation.

ELDON BISBEE,
BERTRAM F. SHIPMAN,
Of Counsel.

File Number
31,226.

Office Supreme Court, U. S.
F. L. E. D.

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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1925.

No. 503.

THE UNITED STATES OF AMERICA,

Petitioner,

vs.

BUTTERWORTH-JUDSON CORPORATION.

IN WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENTS, RECEIVERS OF
BUTTERWORTH-JUDSON CORPORATION.

RUSHMORE, BISBEE & STERN,
Solicitors for Respondents.

ELDON BISBEE,
HENRY ROOT STERN,
H. G. PICKERING,
BERTRAM F. SHIPMAN,
Of Counsel.



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SUMMARY OF THE ARGUMENT.

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In a consent receivership in equity, priority is claimed for contract debts due the United States under the provisions of Section 3466, R. S.

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I.

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CONCLUSION.

Under the provisions of Section 3466, R. S., debts due the United States are not entitled to priority in consent receiverships	44
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1925.
No. 503.

UNITED STATES OF AMERICA,
Petitioner,

against

BUTTERWORTH-JUDSON CORPORATION.

CERTIORARI TO REVIEW A DECREE OF THE UNITED STATES
CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT RECEIVERS.

Statement of the Case.

The question at issue is whether in an equity receivership, consented to by the debtor, contract debts due to the United States are entitled to priority under Section 3466, R. S.

A dispassionate statement of the relevant record facts is as follows:

The creditor's bill was filed by a simple contract creditor.

The bill alleged that the respondent lacked sufficient moneys to meet its current obligations; that the actual value of the respondent's property, if properly and pru-

dently realized on, would be more than enough to pay all of its obligations; that efforts of the respondent in co-operation with its creditors to devise a working agreement had failed; that suits with consequent seizure and sale of property were imminent; that the interests of the respondent and all of its creditors would be served by a continuation of the business; that the interests of all concerned required the appointment of receivers with powers broad enough to permit of the operation of the business with a view to its rehabilitation, or, failing that, the most favorable liquidation (Creditor's Bill, R. 12).

The defendant answered, admitting each and every allegation contained in the bill, and submitting its rights to the protection of the court (R. 17).

An order was entered appointing receivers. The order was consented to by the respondent (R. 17, 20).

The order appointing the receivers recited that the defendant was unable to meet its matured and immediately maturing obligations "though appearing to have assets of large value"; and "that it is necessary for the protection and preservation of the respective rights and equities of the complainant and all other creditors of the defendant that the property and business of the defendant be preserved and administered in this suit through receivers * * * although the defendant is alleged to be solvent" (R. 17).

The United States filed its claim in the sum of \$1,151,450, and thereafter presented a petition for a decree establishing priority of such claim over the claims of other creditors (R. 9).

The original petition of the Government recited the record facts and alleged insolvency of the respondent in fact as of the date of filing the creditor's bill and thereafter.

The petition alleged certain facts which were deleted or modified by stipulation in open court. As so amended, the petition alleged that the admission by the respondent of the allegations in the creditor's bill and its consent to the order appointing receivers was "in accordance with an understanding previously had that it would do so, *the creditors having determined to make an application to the court for the appointment of receivers*" (R. 11).

The petition was met by a motion to dismiss and the cause was heard as upon a demurrer.

The admission of facts incident to the "demurrer" is no broader than the allegations of the petition. Counsel for the Government in his brief, however, states that the question before the court is whether or not the provisions of Section 3466 R. S. can be avoided by "a scheme devised by financiers and reorganization committees with the aid of corporation lawyers to reorganize bankrupt corporations so as

- (a) to squeeze out minority creditors,
- (b) to avoid the prompt winding up and sale of assets with its ratable distribution of proceeds to all creditors, under the Bankruptcy Act, and
- (c) to obtain the wide flexibility of uninterrupted operation for a long period by equity receivers under the protection of an injunction against unfortunate creditors, until the reorganization plans shall be consummated and
- (d) to defeat the United States statutory priority and require it to share ratably with all other unsecured creditors."

The validity of the argument involved in these charges will be considered later.

In this broad statement counsel tenders an issue tantamount to a fraud upon the court and in derogation of the rights of minority creditors and of the rights of the United States.

It is submitted that if the Government purposed to raise such issues it should have done so by proper pleadings in the court below. Had it done so the issues would not have been met by demurrer.

Upon the record as it stands, however, the only issue before the court is as to whether an equity receivership effected in accordance with long established practice sanctioned by the courts, in which insolvency is neither alleged nor admitted, and which is assented to by the debtor because failing that the creditors will take the necessary steps to bring it about, gives rise to the priority provided by Section 3466 R. S., when the element of insolvency in fact subsequently appears of record.

ARGUMENT.

I.

The insolvency of a debtor which gives rise to priority in favor of debts due to the United States under Section 3466, R. S., is limited to insolvency manifested in one of the modes specified in the statute.

Priority in payment of claims due to the United States is not a prerogative of sovereignty but rests exclusively upon statutory provisions. *United States v. State Bank of North Carolina*, 6 Pet. 29 (1832); *United States v. Canal*

Bank, 3 Story 79 (1844); *United States v. Oklahoma*, 261 U. S. 253 (1922).

The only applicable statute and the only one relied upon, is Section 3466, Revised Statutes,* whose text is as follows:

“Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.”

The statute in its first clause provides that debts due to the United States “shall be first satisfied” whenever the person indebted is “insolvent.” In this respect there is no material difference between the original Act of 1797 and the Revision of 1873, now Section 3466.

Ever since its enactment, however, it has been held that the statute did not provide for priority in cases of mere insolvency.

* The several priority Acts were:

Act of July 31, 1789, c. 5, §21, 1 Stat. 42;
Act of Aug. 4, 1790, c. 35, §45, 1 Stat. 169;
Act of May 2, 1792, c. 27, §18, 1 Stat. 263;
Act of March 3, 1797, c. 20, §5, 1 Stat. 515;
Act of July 11, 1798, c. 71, §15, 1 Stat. 594;
Act of March 2, 1799, c. 22, §65, 1 Stat. 676.

In *United States v. Hooe*, 3 Cranch 73 (1805) it was held that "the subsequent sentence is designed to explain the meaning and intent of the term" (p. 91) insolvent.

In *Prince v. Bartlett*, 8 Cranch 431 (1814) this Court said "in the same section, the legislature explain their meaning of insolvency" (p. 433) and reference is made to the last clause of the Act for such explanation and definition.

In *Thelusson v. Smith*, 2 Wheat. 396 (1817) it was held that the mere insolvency or inability of a debtor to the United States to pay all his debts gave no preference to the United States unless it were accompanied by one of the acts specified in the last clause of the statute manifesting the insolvency.

In *Conard v. The Atlantic Ins. Co.*, 1 Pet. 386 (1828) this court, speaking through Story, J., said that

"It is obvious that this latter clause is merely an explanation of the term 'insolvency' used in the first clause, and embraces three classes of cases, all of which relate to living debtors."

"A mere inability of the debtor to pay all his debts is not an insolvency within the statute, but it must be manifested in one of the three modes pointed out in the explanatory clause already referred to" (p. 439).

In *Conard v. Nicoll*, 4. Pet. 291 (1830), this court expressly approved and adopted the charge to the jury by Washington, J., as correctly expressing the law with respect to the statute. In that charge it was said:

"To understand the meaning of this section, we must construe the enacting clause and the proviso together."

"But the inquiry would naturally have arisen in the mind of the legislature: how is the expression insolvency to be understood? This is explained by the proviso; for which purpose alone it is apparent it was introduced" (p. 308).

The charge then proceeds to an exposition of the three modes by which the insolvency is to be manifested.

In *Beaston v. Farmers' Bank of Delaware*, 12 Pet. 102 (1838) the court said:

"No evidence can be received of the insolvency of the debtor until he has been divested of his property in one of the modes stated in the section" (p. 134).

This construction of the statute was thoroughly established, and permeated not only the inferior Federal courts but also the courts of the several States.

In *United States v. McLellan*, 3 Sumner 345 (C. C. Me.) (1838), in an opinion by Associate Justice Story, it is said:

"It is unnecessary, after the various decisions which have been made by the Supreme Court of the United States upon this subject, to enter at large upon the construction of these sections."

"Now, upon the original interpretation of this Act, it might well have been a question whether the three cases thus put were anything more than mere illustrations of the general insolvency spoken of in the preceding clauses of the Act. But that question has long since been put at rest by the Supreme Court of the United States in a variety of cases (cases cited) in which it has been held, that mere inability of the debtor to pay is not an insolvency within the statute, but that it must be such as is manifested in one of the three modes pointed out in this last explanatory clause" (p. 351).

The rule was followed in *Gallagher v. Davis*, 2 Yeates 548 (Penn., 1800), in *Watkins v. Otis*, 2 Pick. 88 (Mass., 1824), and in *Commonwealth v. Phoenix Bank*, 11 Metc. 129 (Mass. 1846).

This court in *United States v. Oklahoma*, 261 U. S. 253 (1923) again reviewed the authorities and, speaking through Mr. Justice Butler, said:

“It establishes priority which is limited to the particular state of things specified. The meaning of the word ‘insolvent’ used in the Act and of the insolvency therein referred to is limited by the language to cases where ‘a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment’, etc. Mere inability of the debtor to pay all his debts in ordinary course of business is not insolvency within the meaning of the Act, but it must be manifested in one of the modes pointed out in the latter part of the statute which defines or explains the meaning of insolvency referred to in the earlier part” (p. 260).

The construction of the statute is no longer open to question. The conclusion of counsel for the Government in the “First Point” of his brief, that the admission by respondent that it was insolvent and the aggregate of its property was not sufficient to pay its debts establishes the fact of insolvency in the special sense required by Section 3466, is contrary to the authorities.

It is perfectly clear from the cases that insolvency in the sense required by Section 3466 is not mere inability to pay one’s debts, but inability to pay one’s debts coupled with a manifestation of that inability in one of the three modes prescribed by the statute.

Eliminating the inapplicable provisions of the statute, it appears that the insolvency must be manifested by (a) the making of a voluntary assignment, or (b) the commission of an act of bankruptcy.

II.

As applied to the case at bar the modes in which insolvency must be manifested to give rise to priority in favor of the United States are all comprehended in the term "act of bankruptcy", as defined in the Bankruptcy Act.

Respondent's contention is that it was not insolvent within the meaning of Section 3466 R. S., i. e., that the insufficiency of its assets to meet its obligations was not manifested in any of the modes required by the statute.

The construction of the statute which leads to this conclusion has two phases. First, the courts have specified the modes in which the insolvency must be manifested; and second, the courts have defined both the nature and effect of the acts manifesting such insolvency, which must exist before priority arises in favor of the Government.

The first phase of this construction of the statute is considered under this point. It answers the contentions of the Government, which are:

First, that the term "voluntary assignment" differs from and is broader than the term "act of bankruptcy".

Second, that the term "act of bankruptcy" cannot be limited to the technical definition of "acts of bankruptcy" contained in the several "Bankruptcy Statutes".

Before passing to a discussion of these arguments, it is necessary to note that the Government asserts in its brief

that our position is that an "act of bankruptcy" means an act followed by actual bankruptcy proceedings and an adjudication in bankruptcy. This has not been our position. We anticipate that the argument will be made in other cases involving the same issue and presented to the Court with the ease at bar. There is authority for the contention. *Conard v. Atlantic Ins. Co.*, 1 Pet. 386; *Conard v. Nicoll*, 4 Pet. 291 (Mr. Justice Washington's charge to the jury); *Beaston v. Farmers' Bank of Delaware*, 12 Pet. 102; *United States v. Clark*, 1 Paine 629; *United States v. King*, 26 Fed. Cas. No. 15,536; *United States v. McLellan*, 3 Sumner 345.

For the purposes of this case, however, as it can be clearly shown that the respondent has neither made a voluntary assignment nor committed an act of bankruptcy within the judicial definition thereof, we do not pursue the argument further.

The first case in which priority arises under Section 3466 is that in which a debtor makes a voluntary assignment. The second case is that in which an act of bankruptcy has been committed.

A voluntary assignment, as an act giving priority to the Government, has been a part of all of the Priority Acts. A general assignment for the benefit of creditors as an act of bankruptcy first appeared in the Bankruptcy Act of 1898. Prior to that Act, the term "voluntary assignment" was construed by the courts to refer to an assignment of all of the property of the debtor for the benefit of creditors. *United States v. Hooe*, 3 Cranch, 73, 91 (1805); *United States v. Howland*, 4 Wheat. 108 (1819); *Field v. United States*, 9 Pet. 182 (1835).

Exactly the same meaning has been assigned to the

term "general assignment for the benefit of creditors" under the Bankruptcy Act of 1898, namely, a transfer of all of the debtor's property for the purposes of liquidation for the benefit of creditors. *In Re Empire Metallic Bedstead Co.*, 98 Fed. 981 (C. C. A. 2nd Cir. 1899); *Vaccaro v. Security Bank of Memphis*, 103 Fed. 436 (C. C. A. 6th Cir. 1900); *In Re McCrum*, 214 Fed. 207, 210 (C. C. A. 2nd Cir. 1914); *In Re Ambrose Matthews and Co.*, 229 Fed. 309, 310 (D. C. N. J. 1916).

From these cases it appears that the term "voluntary assignment" in the Priority Act has dropped out as a separate and distinct Act giving rise to priority and is comprehended within the "act of bankruptcy" specified as a "general assignment for the benefit of creditors" in the Bankruptcy Act.

In effect, therefore, the only mode by which the insolvency of the debtor, giving rise to priority under Section 3466 can be manifested, is by an act of bankruptcy.

The next question is as to whether the "act of bankruptcy" is to be limited to the technical definition of acts of bankruptcy contained in the Bankruptcy Statute. The Government contends that it is not so limited because the several "Priority Acts" were enacted when there was no National Bankruptcy Act.

The hiatus existing from time to time between the priority statutes and national legislation on the subject of bankruptcy is clearly set forth in the review of the legislation in the Government's brief. The argument based thereon, however, overlooks one important consideration.

The earlier Priority Statutes referred to an "act of legal bankruptcy". It was held in *Conard v. Nicoll*, 4 Pet. 291 (1830), this Court approving the instruction of Wash-

ington, J., to the jury, that the phrase "act of legal bankruptcy" referred to State bankrupt laws, or, possibly, any bankrupt law of the United States which might thereafter be passed (page 309). In this state of the law there was, of course, no definite specification of acts of bankruptcy which should be deemed to give rise to Government priority.

The Priority Act of 1797, however, was amended in the revision of 1873. As the statute appeared in the Revised Statutes of that year, the word "legal" was omitted and the statute thus amended by its terms to apply "to cases in which an act of bankruptcy is committed." At the date of this revision the Bankruptcy Act of 1867 was in force, and contained a definition of the term "Act of Bankruptcy".

Since the revision of 1873 the term "Act of Bankruptcy" as used in the Priority Statute has been considered as referring to acts of bankruptcy as defined by the Federal Bankruptcy Act. *United States v. Oklahoma*, 261 U. S. 253.

The acts of bankruptcy as specified in the present Bankruptcy Act are found in Section 3(a), subdivision 4, and so far as pertinent to this case are:

- (1) The making of a general assignment for the benefit of creditors.
- (2) The application by an insolvent for a receiver or trustee of his property.
- (3) The appointment of a receiver or trustee of a debtor's property because of insolvency.

Counsel for the Government is in error in his conclusion that the phrase "act of bankruptcy" as used in the Priority Statute has never been defined by this Court. It

has been indicated by this Court, as above pointed out, that the phrase is now limited to the acts of bankruptcy specified in the Bankruptcy Act. As "voluntary assignment" in the Priority Act has received the same definition as "general assignment" in the Bankruptcy Act, they are now held to be one and the same thing.

The conclusion from the foregoing is that "insolvency" as used in Section 3466 R. S., under the construction given to it by the courts, must now be considered as meaning insolvency evidenced by an act of bankruptcy, as defined in the Bankruptcy Act.

III.

In order to give rise to priority under Section 3466 in the case at bar, the act of bankruptcy must be such as to divest the debtor of title to its property.

In addition to construing Section 3466 with respect to the modes in which the insolvency referred to therein must be manifested, the authorities conclusively establish that the acts manifesting insolvency must be such as to divest the debtor of title to its property. In dealing with this question the courts have construed Section 3466 and Section 3467 together, the latter section being also derived from the earlier priority statutes. Section 3467 provides:

"Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid."

In *United States vs. Hooe*, 3 Cranch. 73, Chief Justice Marshall, construing the Act of 1797, said (p. 91):

“It is observable, that the term insolvency was originally used, and the subsequent sentence is designed to explain the meaning and intent of the term. The whole explanation relates to such a general devestment of property, as would, in fact, be equivalent to insolvency in its technical sense.”

In *Conard vs. Atlantic Insurance Co.*, 1 Pet. 386, Mr. Justice Story, construing the Act of 1799, said (p. 439):

“Insolvency, then, in the sense of the statute, relates to such a general devestment of property as would in fact be equivalent to insolvency in its technical sense. It supposes that all the debtor’s property has passed from him.”

Again at page 440, Mr. Justice Story said:

“Then again, the very enumeration of the cases of insolvency, in all of which the assignment passes and is to pass the whole of the debtor’s property, confirms the interpretation already asserted. They are the very cases where by law there is no exception as to the extent or operation of the assignment to devest the debtor’s estate. One of these is the case of a legal bankruptcy.”

In *Conard v. Nicoll*, 4 Pet. 291, Mr. Justice Washington in his charge to the jury, which was approved by this court, said:

“Nor does it (the Priority Statute), in my opinion, refer the right of preference of the United States to *an act of bankruptcy* unaccompanied by some other act.

"To understand the meaning of this section, we must construe the enacting clause and the proviso together. The former declares no more than that in all cases of insolvency, or where an estate in the hands of an executor, administrator or assignee, should be insufficient to pay all the debts of the deceased, the debts due to the United States should be first satisfied by those persons. It provides for only two cases, viz., a *living* insolvent, *having an assignee*, and a dead insolvent, represented by executors or administrators.

"But the inquiry would naturally have arisen in the mind of the legislature; how is the expression *insolvency* to be understood? This is explained by the proviso; for which purpose alone, it is apparent, it was introduced. It declares that the expression shall extend to the following case, viz.:

"1st. Where a debtor, not having sufficient property to pay all his debts, shall make a *voluntary* assignment thereof for the benefit of his creditors.

"2nd. Where his estate and effects have been attached on account of his being an absconding, concealed, or absent debtor.

"3d. To cases in which an act of legal bankruptcy shall have been committed; that is, as the construction of the proviso in connection with the enacting clause seems necessarily to require, to cases where the property is in the hands of assignees, not by *voluntary assignment* only, but by assignment made in virtue of any state bankrupt law or (possibly) of any bankrupt law of the United States which might thereafter be passed.

"There must be an assignment, either voluntary or compulsory, or else there can be no assignee to be made liable to the United States under the en-

acting clause. If a mere act of bankruptcy be sufficient to give rise to the preference of the United States from the moment of its commission, where is the assignee who is first to satisfy the claims of the United States out of the estate of the debtor, under the penalty, stated in the enacting clause, of satisfying it out of his own estate.

"If it be said that when the assignment of the bankrupt's estate shall be made, the preference of the United States will relate back to the act of bankruptcy so as to overreach intermediate bona fide securities given by the insolvent to creditors: I can only answer, that the assumption is altogether gratuitous, and receives no countenance from any part of this or any other act on this subject" (pp. 307, 309).

In *Beaston vs. Farmers' Bank of Delaware*, 12 Pet. 102, Mr. Justice McKinley, construing the Act of 1797, said:

"From the language employed in this section, and the construction given to it from time to time by this court, these rules are clearly established: first, that no lien is created by the statute; secondly, the priority established can never attach while the debtor continues the owner and in the possession of the property, although he may be unable to pay all his debts; thirdly, no evidence can be received of the insolvency of the debtor until he has been divested of his property in one of the modes stated in the section; and, fourthly, whenever he is thus divested of his property, the person who becomes invested with the title is thereby made a trustee for the United States, and is bound to pay their debt first out of the proceeds of the debtor's property" (pp. 133-134).

In *United States v. Oklahoma*, 261 U. S. 253, Mr. Justice Butler, construing Section 3466 and 3467, said:

“Where the debtor is divested of his property in one of the modes specified in the Act, the person who becomes invested with the title is made Trustee for the United States and bound first to pay its debt out of the debtor’s property. *Beaston v. Farmers’ Bank of Delaware*, 12 Pet. 102, 133-135” (p. 260).

The requirement that under the Priority Statute title to the debtor’s property be divested was particularly emphasized by Chief Justice Shaw in *Commonwealth v. Phoenix Bank*, 11 Metc., 129, 155. He said, referring to the Massachusetts Statute under the authority of which chancery receivers had been appointed for a bank,

“It is wanting in the most essential feature of an insolvent law, that of divesting the debtor of the property, and vesting it in some other persons, and constituting the proceeds a trust fund for creditors, in which it is held that the United States, as *cestui que trust*, have a priority for the payment of their whole debt.”

It thus results that there are three indispensable elements in “insolvency” as that term is used in the priority act, and that the United States to establish its right to priority must show

- (a) That the debtor has not sufficient property to pay its debts, i. e., insolvency in bankruptcy sense;
- (b) The commission of an act of bankruptcy as defined in the Bankruptcy Act;
- (c) That the debtor has been divested of title to its property.

The first element is admitted on the record.

We shall show that neither of the other two necessary elements exists in this case.

IV.

The respondent has not committed an act of bankruptcy and has not been divested of title to its property.

As previously pointed out, the only acts of bankruptcy applicable to the case are:

- (1) The making of a general assignment for the benefit of creditors (including a "voluntary assignment" under the Priority Act).
- (2) The application by an insolvent for a receiver or trustee of his property.
- (3) The appointment of a receiver or trustee of a debtor's property because of insolvency.

It is clear upon the record that no one of these essential prerequisites to the Government priority exists.

1. THE RESPONDENT HAS NOT MADE A GENERAL ASSIGNMENT FOR THE BENEFIT OF CREDITORS (NOR A "VOLUNTARY ASSIGNMENT" UNDER THE PRIORITY ACT).

A general assignment for the benefit of creditors has a well defined and universally understood meaning. It is a transfer by the debtor of all of his property to a trustee for the purpose of liquidation and distribution among all of his creditors.

Judge Lurton, in *Vaccaro v. Security Bank of Memphis*, 103 Fed. 436 (C. C. A., 6th Cir.) defined the term as follows:

"A general assignment is the voluntary act of a debtor, whereby he transfers his property to a trustee for the benefit of creditors. Its nature and characteristics were well understood" (p. 439).

In *In Re Empire Metallic Bedstead Co.*, 98 Fed. 981 (C. C. A., 2nd Cir.), the court said:

"The term (general assignment) has a universally understood and recognized meaning throughout the different states, and means a transfer and conveyance by a person of all his property to a named person upon a trust which is to be worked out in some states by a court of probate and insolvency, in some states by a court of common law, and in some states by a trustee, subject only to the supervision to which any trustee is subjected. It is a deed or conveyance which the grantor makes voluntarily, or sometimes by compulsion, at the instance of a court of insolvency" (p. 982).

In *Beaston v. Farmers' Bank of Delaware*, 12 Peters 102, this Court, referring to voluntary assignment under the priority statutes, said:

"No one can be divested of his property by any mode of conveyance, statutory or otherwise, unless at the same time, and by the same conveyance, the grantee becomes invested with the title" (p. 136).

The Government suggests that the lack of a formal *instrument* of conveyance does not establish that there was

X // no general assignment, because the same thing may be accomplished by an *act*. This may be conceded.

X If, however, an act be relied upon as effecting a general assignment in lieu of a formal instrument, such act must be the equivalent of such instrument in purpose and effect. A general assignment for the benefit of creditors is evidenced only where there exists the purpose of liquidation and distribution, and a divestment of the debtor's title to the property is effected.

The act which was done in this case was not a voluntary or general assignment for the benefit of creditors.

(a) The receivers were not appointed for the purpose of liquidation and distribution, but for the purpose of conserving the assets of the corporation and continuing its business for the benefit of the creditors and the corporation until it should be determined either that the property should be returned to the corporation or that the interests of the parties concerned required a liquidation or distribution.

(b) There was no divestment of the debtor's title to its property because it has been held that such divestment is not effected by an equity receivership.

In *Quincy, Missouri and Pacific R. Co. v. Humphreys*, 145 U. S. 82, at page 98, the Court said:

✓ "The ordinary chancery receiver, such as we have in this case, is clothed with no estate in the property, but is the custodian of it for the Court * * *."

It was held in *Great Western Mining and Mfg. Co. v. Harris*, 198 U. S. 561, that an equity receiver did not acquire title to the debtor's property.

In *Pusey & Jones Co. v. Hanssen*, 261 U. S. 491, it was said that

"The appointment of a receiver is merely an ancillary and incidental remedy. A receivership is not final relief. The appointment determines no substantive right; nor is it a step in the determination of such a right. It is a means of preserving property which may ultimately be applied toward the satisfaction of substantive rights" (p. 497).

Furthermore, in *Quincy, Missouri and Pacific R. Co. v. Humphreys*, *supra*, the distinction between an equity receiver and an assignee in bankruptcy was pointed out in the following words:

"It is manifest that the scope of his duties and powers are very much more restricted than those of an assignee in bankruptcy or insolvency. In the case of an assignee in bankruptcy, the law casts upon such assignee the legal title * * *" (p. 98).

2. THE RESPONDENT DID NOT APPLY FOR THE APPOINTMENT OF A RECEIVER OR A TRUSTEE FOR ITS PROPERTY.

The receivers were appointed on the application of creditors of the debtor. The debtor did not procure or instigate the proceedings. It filed an answer admitting the allegations of the bill and submitted its rights in the premises to the protection of the court, and by its attorneys consented to the order appointing the receivers. It did not join in the prayer of the bill for the appointment of the receivers. The consent was "in accordance with an understanding previously had that it would do so" (R. 6) but only after the creditors had determined to make the application (R. 11).

It has been repeatedly held that where a corporation in its answer to a creditor's bill joins in the prayer for the appointment of a receiver, it does not apply for the appointment of a receiver within the meaning of the Bankruptcy Act.

"If the company, while insolvent, had voluntarily brought an action to wind up its affairs for the benefit of its creditors, and had applied for the appointment of receivers to take charge of its property, the superior right of the bankruptcy court could not safely be questioned; but the interposition of an answer in an action brought by a contract creditor, admitting therein the truth of the allegations of the bill and joining in the prayer for relief, is not believed to be the equivalent of the term 'being insolvent', applied for a receiver or trustee for its property. * * *

"It is only where a receiver has been appointed in another court because of insolvency, as that term is defined in the bankruptcy law, or where the corporation on its own initiative has applied for the appointment of a receiver or custodian of its property, that an act of bankruptcy under section 3a(4) has been committed." *In re Edward Ellsworth Co.*, 173 Fed. 699, (W. D. N. Y.)

To the same effect are the following:

In re Morosco Holding Co., Inc., 296 Fed. 516 (S. D. N. Y.);

In re Conn. Brass & Mfg. Corp., 257 Fed. 445 (Conn.);

Moss National Bank v. Arend, 146 Fed. 351 (C. C. A., 6th Cir.);

Missouri Valley Cattle Loan Co. v. Alexander,
276 Fed. 266 (C. C. A., 8th Cir.);
In re Wm. S. Butler & Co., Inc., 207 Fed. 705
(C. C. A., 1st Cir.).

“Mere consent, which is passive, is not tantamount to application, which is affirmative.” *In re Gold Run Mining & Tunnel Co.*, 200 Fed. 162 (D. Colo.)

We have found no case in which it has been held that a corporation applied for a receiver within the meaning of the Bankruptcy Act by admitting the allegations of a creditor’s bill and consenting to the entry of an order appointing receivers in equity. There is a dictum to that effect in *In re Billy’s Ice Cream Co.*, 295 Fed. 502, 503 (C. C. A., 7th Cir.) which is based upon an obviously erroneous understanding of the ruling in *Missouri Valley Cattle Loan Co. v. Alexander*, 276 Fed. 266, 269, *supra*.

3. NO RECEIVER OR TRUSTEE HAS BEEN PUT IN CHARGE OF THE RESPONDENT’S PROPERTY BECAUSE OF INSOLVENCY.

The creditor’s bill under which the receivers were appointed contained no allegation that the corporation was insolvent or that its liabilities exceeded its assets. On the contrary, it alleged “that the actual value of all of the defendant’s property, if properly and prudently realized on, would be more than enough to pay off all of its said obligations.” (R. 13.)

The order appointing the receivers recited “that the defendant, though appearing to have assets of large value, is now unable to meet its matured and immediately maturing obligations and will continue for a considerable time to

be unable to meet such matured and maturing obligations or any substantial portion thereof * * * that it is necessary that receivers of the defendant and of its property should be appointed forthwith, although the defendant is alleged to be solvent." (R. 17.)

The act of bankruptcy in question is that part of Section 3a(4) of the Bankruptcy Act which provides as follows:

"Because of insolvency a receiver or trustee has been put in charge of his property * * *."

A person is insolvent under the Bankruptcy Act, Section 1a(15), when the aggregate of his property at a fair valuation is not sufficient in amount to pay his debts. The definition of insolvency contained in the Bankruptcy Act is the test by which to determine whether such act of bankruptcy had been committed. *United States v. Oklahoma*, 261 U. S. 253, 262.

A similar ruling was made in *In re Wm. S. Butler & Co.*, 207 Fed. 705 (C. C. A., 1st Cir.). The court said:

"The situation in this case resolves itself into this: That Butler & Co., being insolvent in the bankruptcy sense, was put into the hands of receivers. This, however, is not an act of bankruptcy as defined in clause 4, as amended in 1903, and it is apparent that Congress did not intend to make it one. The amendment when introduced read: 'Being insolvent, applied for or was put in the hands of a receiver.'

"In the Senate its language was changed to read as finally enacted. Had it become a law as originally introduced, the facts in this case would disclose an act of bankruptcy, but, by enacting the clause as amended by the Senate, Congress manifested an intention to leave the situation presented by this case unprovided for; and it is not for the court to enlarge

the meaning of the statute by construction and attempt to provide for the omitted situation by holding that the phrase, 'because of insolvency', means insolvency other than as defined in section 1, cl. 15."

This ruling was followed in *In re Valentine Bohl Co.*, 224 Fed. 685 (C. C. A., 2nd Cir.).

It is further settled that the appointment of a receiver to take charge of the property of an insolvent does not constitute an act of bankruptcy unless the receiver is appointed because of insolvency; that whether or not the corporation was in fact insolvent is wholly immaterial if the receiver was not in fact appointed because of insolvency; and that the record in the receivership action is conclusive upon the question.

It was so held in *In re Spalding*, 139 Fed. 244 (C. C. A., 2nd Cir.), in which case the court said:

"It suffices that the court in exercising its authority did not purport to do so upon that ground, and that the order appointing the receiver and reciting the grounds for the action of the court is conclusive to the contrary. * * * If the court had merely appointed a receiver, without reciting the grounds of its judgment, the record could have been referred to, or the grounds shown by evidence *aliunde*. *Russell v. Place*, 94 U. S. 608, 24 L. Ed. 214; *Davis v. Brown*, 94 U. S. 428, 24 L. Ed. 204. But, having recited the grounds, the recitals cannot be contradicted without impeaching the record; and this is inadmissible."

The several propositions are supported also by

E. B. Badger Co. v. Arnold, 282 Fed. 115 (C. C. A., 1st Cir.);

Zugalla v. International Mercantile Agency, 142 Fed. 927 (C. C. A. 3rd Cir.);
Maplecroft Mills v. Childs, 226 Fed. 415, (C. C. A. 4th Cir.);
Anderson v. Myers, 296 Fed. 101 (C. C. A. 5th Cir.);
Moss National Bank v. Arend, 146 Fed. 351 (C. C. A. 6th Cir.);
In re Golden Malt Cream Co., 164 Fed. 326 (C. C. A. 7th Cir.);
Exploration Mercantile Co. v. Pacific Hardware Co., 177 Fed. 825, 840 (C. C. A. 9th Cir.).

There can be no doubt, under the authorities, that insolvency in fact, in the bankruptcy sense, is wholly immaterial unless it appear of record that the receiver was put in charge of the debtor's property because of such insolvency. This is conclusively determined by *United States v. Oklahoma*, 261 U. S. 253, 262-263 and *U. S. F. & G. Co. v. Strain*, 264 U. S. 570 (affirming 292 Fed. 694). The Oklahoma case first established that the receiver must be put in charge of the debtor's property because of insolvency in the bankruptcy sense before priority could arise. Subsequent cases seeking to establish government priority undertook to distinguish the Oklahoma case upon the ground that insolvency in fact did not appear of record. This was particularly urged upon the court in the Strain case both in the Circuit Court of Appeals and in this Court. In the brief in this Court it was argued:

“The question in that case (Oklahoma case) was whether Section 3466 applied in the absence of a

showing of insolvency in fact, while here the question is whether Section 3466 applies in the presence of a showing of insolvency in fact." (Brief of Appellant No. 656, October Term, 1923, p. 32.)

In response to this contention the Circuit Court of Appeals had held (292 Fed. 694) that since the Bank Commissioner had not taken over the bank because of the insolvency, the Government was not entitled to priority. On appeal this Court sustained the decision without opinion.

To counteract the effect of the authorities above cited, the Government argues that the consent receivership was an act of bankruptcy and that it was a manifestation of insolvency within the meaning of Section 3466.

There are two answers to the contention. First, it has been conclusively held that the appointment of an equity receiver, whether by consent or otherwise, is not an act of bankruptcy. Second, it has been held that the appointment of an equity receiver is not the equivalent of a general or voluntary assignment under Section 3466.

The first point is disposed of by the following cases:

+ In *In Re Empire Metallic Bedstead Co.*, 98 Fed. 981 (C. C. A., 2nd Cir.), it was held that the appointment of a receiver under circumstances similar to those in this case did not constitute a general assignment for the benefit of creditors under the Bankruptcy Act. There the corporation itself applied for the appointment of a receiver of its property on the ground of its insolvency and for the purposes of dissolution, liquidation and distribution. At that time the application by a debtor corporation for the appointment of a receiver was not an act of bankruptcy, but

a general assignment for the benefit of creditors was. The court said:

“When the statute declares that a general assignment for the benefit of creditors is an act of bankruptcy, can it be construed to include an act which is not a general assignment? We think that it cannot, because the term has a universally understood and recognized meaning throughout the different states, and means a transfer and conveyance by a person of all his property to a named person upon a trust which is to be worked out in some states by a court of probate and insolvency, in some states by a court of common law, and in some states by a trustee, subject only to the supervision to which any trustee is subjected. It is a deed of conveyance which the grantor makes voluntarily, or sometimes by compulsion, at the instance of a court of insolvency. *A petition for the appointment of a receiver is not that proceeding which is universally recognized as an assignment, and its ‘equivalency’ of result, if equivalency exists, is not important.* The bankruptcy statute has said that the one is an act of bankruptcy, and has said nothing about the other, in direct terms; and when acts of bankruptcy are classified, as they are in the statute of 1898, it is not the province of a court to enlarge the classification because the omitted class seems to partake of the sin of the named class. Why the legislature did not specifically mention acts of corporations which would have the effect of a general assignment, but which are of a different character, it is unnecessary to surmise; for it is, in our opinion, sufficient to say that these other acts are not assignments, and were not particularly specified, and that,

if they are acts of bankruptcy, it is because they are included in the general language of one of the other subdivisions of section 3 of the act" (p. 982).

In *Vaccaro v. Security Bank of Memphis*, 103 Fed. 436 (C. C. A., 6th Cir.), the administrator of a deceased partner applied for a receiver to liquidate the partnership. The other partners did not oppose. A petition in bankruptcy was filed alleging the receivership as a "general assignment for the benefit of creditors." After stating that no evidence existed of the procurement of the receivership by the surviving partner, Judge Lurton said:

"But if the facts be regarded as substantially proving that the Vaccaros consented to the proceeding by agreeing to make no opposition, so that the proceeding could not be regarded as purely one *in invitum*, we are still of opinion that the appointment of a receiver under such a suit, and for the bona fide purpose of liquidating the affairs of a partnership dissolved by death, was not the making of a general assignment within the meaning of the bankrupt act" (p. 439).

After defining "general assignment" (quoted, *supra*, p. 19), Judge Lurton continued:

"It is not enough to say that, if the same consequences ensue from the appointment of a receiver, the one act is the equivalent of the other in law. * * * We are not disposed to construe the provisions of subdivision 4 of Section 3 as including anything as a general assignment unless it is clearly one of those assignments known to the common law

as a general assignment. The mere fact that the consequences which attach to the appointment of a receiver for the purpose of winding up a partnership or a corporation are similar to those which result to creditors from a general assignment is not enough" (pp. 439 and 440).

See also:

In re Harper & Bros., 100 Fed. 266;

Davis v. Stevens, 104 Fed. 235;

In re Gilbert, 112 Fed. 951;

In re Henry Zeltner Brewing Co., 117 Fed. 799;

In re Burrell, 123 Fed. 414.

† The second point is settled by the authorities cited below:

In *Beaston v. Farmers' Bank of Delaware*, 12 Pet. 102, the court said:

"We are next to inquire into the legal effect of the appointment of receivers by the Circuit Court. Without deciding whether a Circuit Court of the United States has authority, in a case like this, to appoint receivers, with power to take possession of all the property of a debtor of the United States, it is sufficient to say in this case, that it does not appear that the power conferred on the receivers was ever executed; and if it had been, it would not have been a transfer and possession of the property of the Elton Bank, within the meaning of the Act of Congress, and, therefore, the priority could not have attached to the funds in their hands" (p. 136).

"* * * No one can be divested of his property by any mode of conveyance, statutory or otherwise, unless at the same time, and by the same conveyance, the grantee becomes invested with the title" (p. 136).

In *Commonwealth v. Phoenix Bank*, 11 Metc. 129, 155, Chief Justice Shaw pointed out that the receivers appointed under the State statute were appointed "as receivers, in a proceeding directed to be conducted 'according to the course of chancery proceedings,'" and he proceeded to show that as such receivers, title to the bank's property was not vested in them, but their authority with respect to the property was dependent upon and subject to the orders of the court which appointed them. The language of the opinion in this regard is peculiarly applicable to this case. He said:

"They (the receivers) are officers of the law, subject in all respects to the orders and directions of the court. The law requires no assignment to be made to them, either by the bank or by any authorized court or officer. In practice, none is usually made, and none has been made in this case. They are to take possession of the property and effects of the corporation, subject to the rules and orders of the court. Their power to sell and convert the property into money is not given them by statute, or by any assignment or transfer, but it depends wholly on the order of the court. The distribution of the proceeds amongst bill holders and other creditors, and the residue, if any, to stockholders—a feature so essential to every system of bankrupt or insolvent law—is not provided by this statute, but results only from the orders and decrees of the court, regulated by those principles of equity which govern all courts in the disposition of funds directed to be administered according to the course of chancery proceedings. Although, therefore, the proceedings under this law, in their ultimate results, and in some states of facts, operate like an insolvent law for

this class of corporations, this is not the declared nor obvious purpose, nor the necessary consequence of the law" (p. 155).

These authorities demonstrate conclusively the error of the contention of the United States that the requirement of the priority statute is satisfied by a divestment of the debtor's possession and control of his property. Divestment of property signifies transfer of title. Section 3467 can come into operation only when there has been a divestment of title of the debtor's property by a transfer, either voluntary or by operation of law to a trustee who thereupon becomes a trustee for the United States with respect to its right to priority.

The insolvency of the debtor in this case has not been manifested as required by the statute as a prerequisite to the Government's priority because

- (1) The receivership did not constitute either a voluntary or general assignment as defined by the courts.
- (2) A consent receivership cannot, under the authorities, be held to be an application by an insolvent for the appointment of a receiver.
- (3) The record conclusively establishes that a receiver was not put in charge of the respondent's property because of insolvency as defined in the Bankruptcy Act.
- (4) Neither the acts of the respondent in admitting the allegations of the bill and consenting to the order appointing receivers, nor the receivership which followed, were effective to divest the respondent of title to its property.

(5) The established construction of Section 3466 does not permit of the inclusion of a consent receivership as one of the modes in which insolvency must be manifested.

V.

The authoritative construction of the statute and the declared legislative policy with respect to Government priority preclude any extension of Section 3466 by construction as contended for by the Government.

The brief of the Government, in effect, if not expressly, admits that within the technical construction of Section 3466 there has been no voluntary assignment and no act of bankruptcy on the part of the respondent.

The gist of the Government's argument is that the equity receivership by consent is an evil which should induce the court to construe Section 3466 as including the divestiture of the debtor's possession and control of its property through a consent receivership as a manifestation of insolvency.

Four claims are advanced to sustain the argument:

- (1) That consent receiverships are in effect fraudulent;
- (2) That the business policy served by consent receiverships favors reorganization interests as against minority creditors and the Government;
- (3) That the consent receivership defeats Government priority; and
- (4) That public policy with respect to Government priority requires a liberal construction of the statute.

With respect to the first claim it is argued in the Government's brief that "in case after case of known hopeless insolvency" the "device" of a consent receivership is employed. It is asserted that to this end solvency is alleged in the bill "and the debtor answers admitting solvency when he knows it is untrue."

When cases arise in which fraud upon the court exists, we think the proceeding should be challenged. There is nothing in the record here, however, to disclose that the creditors who filed the bill had any knowledge that the debtor was hopelessly insolvent. There is nothing in the bill to indicate that the debtor was hopelessly insolvent or that it did not honestly believe that with the benefit of a moratorium under an equity receivership its financial embarrassment could be overcome to the best interests of creditors and of itself.

Certainly this case should not be determined upon circumstances which counsel asserts to have existed in other cases and upon facts not here of record.

With respect to the second claim it may be said that it does not appear that any reorganization committee is interested in this receivership. It does not appear that any minority creditors have been prejudiced and no creditor has intervened in the proceedings alleging any fraud upon him or injury to him.

On the contrary the allegations of the petition, admitted by the answer, were to the effect that the receivership was in the interest of all creditors. The Receivers, charged with the duty of impartially representing all creditors, are the only persons before the court.

That general consideration of business policies should be controlling in the matter of statutory construction

is open to serious doubt. But granting that it may, the argument overlooks the facts that successful receiverships are not uncommon, and that the prompt winding up of the business of financially embarrassed debtors and the sale of assets in pursuance of the relatively inflexible bankruptcy procedure do not necessarily serve the best interests of creditors generally or of the United States as a creditor. In most instances the continuation of the business as a going concern not only affords the widest opportunity for securing the maximum price in the event of sale, but leaves open the possibility of complete rehabilitation without loss to creditors.

We refer to *Graselli Chemical Co. v. Aetna Explosives Co., Inc.*, 252 Fed. 456 (C. C. A. 2nd Cir.). The statement of facts contained in that case contains the following:

“The receivers have so conducted the business that all parties to this controversy are enthusiastic about the success achieved. * * * The profits for the year ending December 31, 1917, have been so large that the surplus of assets over liabilities shown by the receivers’ consolidated balance sheet of the defendant and its subsidiary companies on December 31, 1917, is \$538,647. The creditors other than those represented by the bonded indebtedness, have been paid 50 per cent. of their claims, and it is now said that the receivers have approximately \$3,000,000. The excellent condition of the business conducted by the receivers indicates that in the near future the balance of all valid claims against the defendant will be paid; the bonded indebtedness may be paid, and the property returned to the stockholders free of debt, with unimpaired credit, and with ample working capital.”

An equally successful result was obtained in the re-

ceivership proceeding entitled, Wendell P. Colton Company against New York and Cuba Mail Steamship Company, Equity No. E 28-236 United States District Court for the Southern District of New York. The property of the company was returned to it in August of this year with its debts paid in full or provision made for such payment. The receivership was in effect for only a year and a half.

It was said by this Court in *Re Metropolitan Railway Receivership*, 208 U. S. 90, 112:

“There are cases—and the one in question seems a very strong instance—where in order to preserve the property for all interests, it is a necessity to resort to such a remedy (equity receivership). A refusal to appoint a receiver would have led in this instance almost inevitably to a very large and useless sacrifice in value of a great property, operated as one system through the various streets of a populous city, and such a refusal would also have led to endless confusion among the various creditors in their efforts to enforce their claims, and to very great inconvenience to the many thousands of people who necessarily use the road every day of their lives.”

The third claim is wholly illogical. It recites that the purpose and effect of the consent receivership is “to defeat the United States’ statutory priority and to require it to share ratably with all other unsecured creditors” (by evading bankruptcy). It passes over without comment the case of *Davis v. Pringle*, 269 U. S. , 45 Sup. Ct. Rep. 549 which held that the Government was not entitled to priority in bankruptcy proceedings.

Surely the consent receivership cannot defeat a priority in bankruptcy which does not exist. If, as contended for

by the Government, the only recourse of a financially embarrassed corporation is bankruptcy, the Government's priority will be defeated irrespective of the construction of Section 3466.

To bolster up this claim it is asserted that the United States at least loses its priority for taxes, which is expressly preserved in the Bankruptcy Act. This assumes either that Section 3466 does not provide for priority of tax claims, or that the respondent's contention if sustained will defeat priority with respect to taxes as well as contract debts. As this question has not been decided by the courts, the assumption is wholly unwarranted.

But granting, and we think it should be so held, that the Government has no priority for tax claims in receivership proceedings, it does not follow that Section 3466 should be liberally construed.

The final claim of the Government, that considerations of public policy require that Section 3466 should be construed to include within the scope of its definition of insolvency the consent to an equity receivership where insolvency in the bankruptcy sense appears, cannot be sustained.

Equity receiverships by consent have come to be a common method for dealing with the affairs of debtors, particularly large corporate interests. They have had the sanction of this Court at least since 1908 (*Re Metropolitan Ry. Receivership*, 208 U. S. 90) and of the courts generally. The parties to such proceedings are acting within their legal rights in accordance with an approved practice, and if the effect thereof be to prejudice the interests of the public to any alarming extent or to avoid a priority which the Government might otherwise enjoy, the fact that Congress has

not in the course of seventeen years seen fit to remedy the situation is significant.

In so far as the question of Government priority is concerned, the only recent legislation has had the effect of restricting it (Bankruptcy Act of 1898). Mr. Justice Holmes, speaking for this Court, in *Davis v. Pringle*, 269 U. S. , 45 Sup. Ct. Rep. 549, holding that Government priority no longer existed in bankruptcy, said:

"Public opinion as to the peculiar rights and preferences due to the sovereign has changed."

The conclusive answer to the argument is that Congress has limited the priority of the United States to the specific instances enumerated in the statute and the courts have refused to extend their application.

The unwillingness of the courts to enlarge the scope of the statute even in a case where it was recognized that the situation presented was in substance similar to the cases enumerated in the priority statute, and indeed presented a more serious inequality than would have resulted from the acts specifically mentioned in the statute, is shown by the opinion of Mr. Justice Story in *United States v. McLellan*, 3 Sumner, 345 (C. C., Me.).

In that case the debtor by two separate instruments conveyed all of his property to two of his creditors in order to discharge indebtedness owing to them. Debts owing to the United States and other creditors were unprovided for. The United States asserted priority and it was recognized that if equivalency of result was to be the test of the scope of the priority statute, the case would come within its provisions and the Government would be entitled to priority. Mr. Justice Story, however, held, following and referring

to the cases in which this Court had construed the statute, that the three cases enumerated in the statute were not mere illustrations of the general insolvency referred to in the preceding clause of the priority statute, but that they were the only instances in which the Government was entitled to priority and that the enumerated instances were not to be extended by liberal interpretation. Answering a suggestion similar to the argument here advanced that the statutes should be broadly construed in order to include a situation equivalent to those enumerated in the statute, Mr. Justice Story said:

“That it is a case within the same mischief, as that against which the Act meant to provide, I admit. That if the case had been wholly untouched by authority, there might have been strong ground to contend, that the three cases put in the Act were rather illustrations of the meaning of the word, insolvency, as used in the Act, than exclusive limitations of its meaning, I also admit. But, looking to the decisions, which have been made, I do not feel warranted in saying, that such conveyances, as the present, are voluntary assignments for the benefit of creditors within the meaning of the Act, unless, indeed, it could be shewn, that they were made with the intent to evade the priority given by the Act” (pp. 357-8).

It is to be noted that the foregoing opinion is by Mr. Justice Story. He also wrote the opinion of this Court in *Conard v. The Atlantic Insurance Company*, 1 Pet. 386. In all of his opinions with respect to the construction of the statute as to the cases in which priority existed he has, to paraphrase the opinion next quoted, discovered a due regard to the principle of strict construction. The state-

ment by Mr. Justice Story in *United States v. State Bank of North Carolina*, 6 Pet. 29, cited in the Government's brief to the point that the statute should be liberally construed is distinguishable. That opinion was also written by Mr. Justice Story. He there held that the requisite conditions giving rise to priority being present, the statute which conferred upon the United States the ancient sovereign right of priority should be so construed as to include debts of every character comprised within that right.

In *Watkins v. Otis*, 2 Pick. 88 (Mass. 1824) the court, referring to the earlier decisions of this Court construing the priority statute, said:


"It is proper that this high prerogative right of the United States should be construed strictly, as it is in derogation of the rights of creditors; and the Supreme Court of the United States have discovered a due regard to this principle in their decisions. A government which has the power to take, should never be allowed more than by express terms it demands; for the doctrine of implication here might swallow up all individual rights" (pp. 101-102).

There is no indication in any of the later cases of any change in the judicial policy of construction. Every case in which the issue of construction of Section 3466 has arisen involves an effort to persuade the court to liberalize the construction of the statute so as to extend the scope of the acts giving rise to priority. In every case such extended construction has been denied.

The principle applied by the courts in these cases is precisely the same as that applied in the cases construing the definition of an act of bankruptcy under the Bankruptcy Act. See pages 27 to 30, *supra*.

There is nothing in the nature of equity receiverships as such, there is no consideration of public policy reflected in any legislative act, and there is no judicial comment with respect to Section 3466 to warrant the construction contended for by the Government.

VI.

The cases in the Circuit Courts of Appeals relied upon by the Government are erroneously decided and do not vitiate the conclusions here reached.

The case at bar was decided, without opinion, upon authority of *Equitable Trust Co. v. Connecticut Brass & Mfg. Corp.*, 290 Fed. 712 (C. C. A., 2d Cir.). In that case insolvency in the bankruptcy sense appeared of record and the debtor had filed its answer in the receivership proceedings admitting the averments contained in the bill and joining in the prayer for the appointment of receivers. It was held that the insufficiency of the debtor's assets to pay its debts was not manifested by an act which divested it of its property and that priority must be denied under the decisions of the Supreme Court extending over a period of more than one hundred years.

In *Liberty Mutual Ins. Co. v. Johnson Shipyards Corp.*, 6 Fed. (2d) 752 (C. C. A., 2d Cir.), the court said, speaking of the Equitable Trust Co. case, that:

“This Court denied the right to priority on the ground that the right of the United States to priority in the payment of debts was statutory, and that Section 3466, which provided for the priority of payment of Government debts under prescribed

conditions, had no application to the case of the distribution of the assets of an equity receivership." (p. 754).

The Second Circuit is supported by the Sixth Circuit in the case of *Davis v. Michigan Trust Co.*, 2 Fed. (2d) 194.

Davis v. Pullen, 277 Fed. 650 (C. C. A., 1st Cir., 1922), involved a consent receivership in which solvency was alleged and admitted. It subsequently developed that the debtor was insolvent in the bankruptcy sense. The court held (reversing the District Court) that the assent of the debtor to receivership, coupled with the bankruptcy insolvency, was a sufficiently notorious act of insolvency to meet the requirements of Section 3466.

As this case was decided prior to *United States v. Oklahoma* (261 U. S. 253), the Circuit Court of Appeals did not have the benefit of the opinion of this Court in that case. The decision wholly disregards the essential element of divestiture of title to the debtor's property which, from the beginning, has been held by this Court to be the *sine qua non* of priority under Section 3466.

This long line of decisions in this Court culminates in *United States v. Oklahoma*, 261 U. S. 253, and *U. S. F. & G. Co. v. Strain*, 264 U. S. 570 (affirming 292 Fed. 696), in which it is definitely established that priority under Section 3466 rests solely upon insolvency in the bankruptcy sense manifested by an act of bankruptcy which divests the debtor of title to his property.

The Court of Appeals for the First Circuit had previously held in *In Re William S. Butler & Co.*, 207 Fed. 705, and *E. B. Badger & Co. v. Arnold*, 282 Fed. 115, that it would not enlarge the meaning of the Bankruptcy Act by

construction so as to make the appointment of an equity receiver an act of bankruptcy. Had the court appreciated that the same principle of construction applied to Section 3466, as was subsequently reannounced in the Oklahoma case, it would have followed its rulings in the Butler and Badger cases.

The Fifth Circuit, in *Davis v. Miller-Link Lumber Co.*, 296 Fed. 649, held (reversing the District Court) that in a consent receivership, where insolvency in the bankruptcy sense was alleged in the Government's petition for priority and admitted in an agreed statement of facts, there was an act of bankruptcy which gave rise to the priority under Section 3466. The court in this case, appreciating that divestiture of the debtor's title was an essential prerequisite to priority, disposes of the question by holding that "an act which under the circumstances is reasonably expected to have substantially the same result as the making * * * of a general assignment for the benefit of his creditors, namely, the divesting of his title to such property" is the equivalent of such general assignment. It bases its decision upon an opinion of its own in *Moody-Horman-Boelahuew v. Clinton Wire Cloth Co.*, 246 Fed. 653, to the effect that the name under which a general assignment is effected is not conclusive. It overlooks the fact that in the case relied upon there was an actual statutory divestiture of the debtor's title to his property. It holds that an act which may or may not result in such divestiture is the equivalent thereof if in the opinion of the court it is reasonably to be expected that it will so result.

In *Bramwell v. U. S. F. & G. Co.*, 9th Circuit, 299 Fed. 705, the debtor was a bank whose assets had been turned over to the State Superintendent of Banks by resolution

of its Board of Directors for the purpose of liquidation. The court here finds it necessary to evade the strict requirements of divestiture of title to the debtor's property. It attempts to do so by holding that the title was in abeyance but must be inevitably divested in order to carry out the purpose of the resolution. This is in error. Title divests and revests simultaneously, whether by formal instrument or otherwise (*Beaston v. The Farmers' Bank of Delaware*, 12 Pet. 102). We are not concerned with the effect of the State statutes in the *Bramwell* case. Unless the debtor was divested of title to its property and title thereto passed to a trustee chargeable under Section 3467, the case is contrary to authority.

The three cases in the First, Fifth and Ninth Circuits arrived at the conclusion that priority arises under Section 3466 whenever there is an act of the debtor manifesting his insolvency in a manner which is, in the opinion of the court, substantially the equivalent of an act of bankruptcy divesting him of title to his property. This is the real ground upon which the Government's claim of priority in this case is based.


The argument for priority, based upon the "doctrine of equivalency", is without foundation either in reason or authority. We have already shown that this contention is directly in conflict with the decisions of this Court and the weight of authority elsewhere.

Conclusion.

Priority with respect to debts due to the United States exists only in cases of insolvency as defined in Section 3466.

The unqualified definition of "insolvency" in the Pri-

ority Act is that it consists of an insufficiency of the debtor's assets to meet his liabilities manifested by an act of bankruptcy of such a character as to divest the debtor of title to his property.

For something over one hundred and twenty-five years this Court, and the courts generally, have refused to extend the construction of the statute so as to accord priority in any case not coming within the statutory definition of insolvency.

No considerations of policy upon the record, or extraneous to it, warrant any departure from the established construction.

A consent receivership is not a manifestation of insolvency within the definition of the statute and the Government is not entitled to a priority for contract debts in such proceedings.

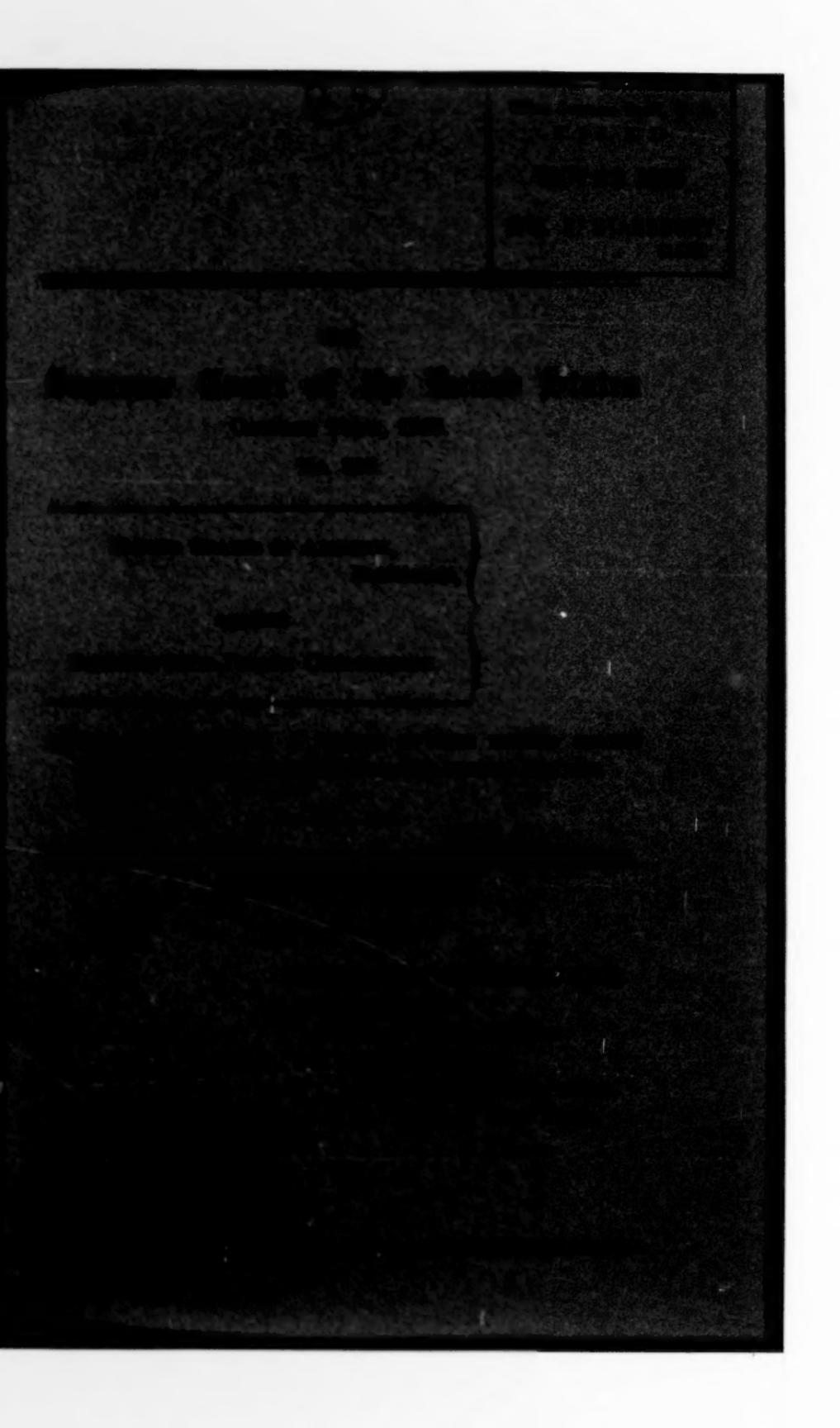
It follows that the decision of the Court of Appeals should be affirmed.

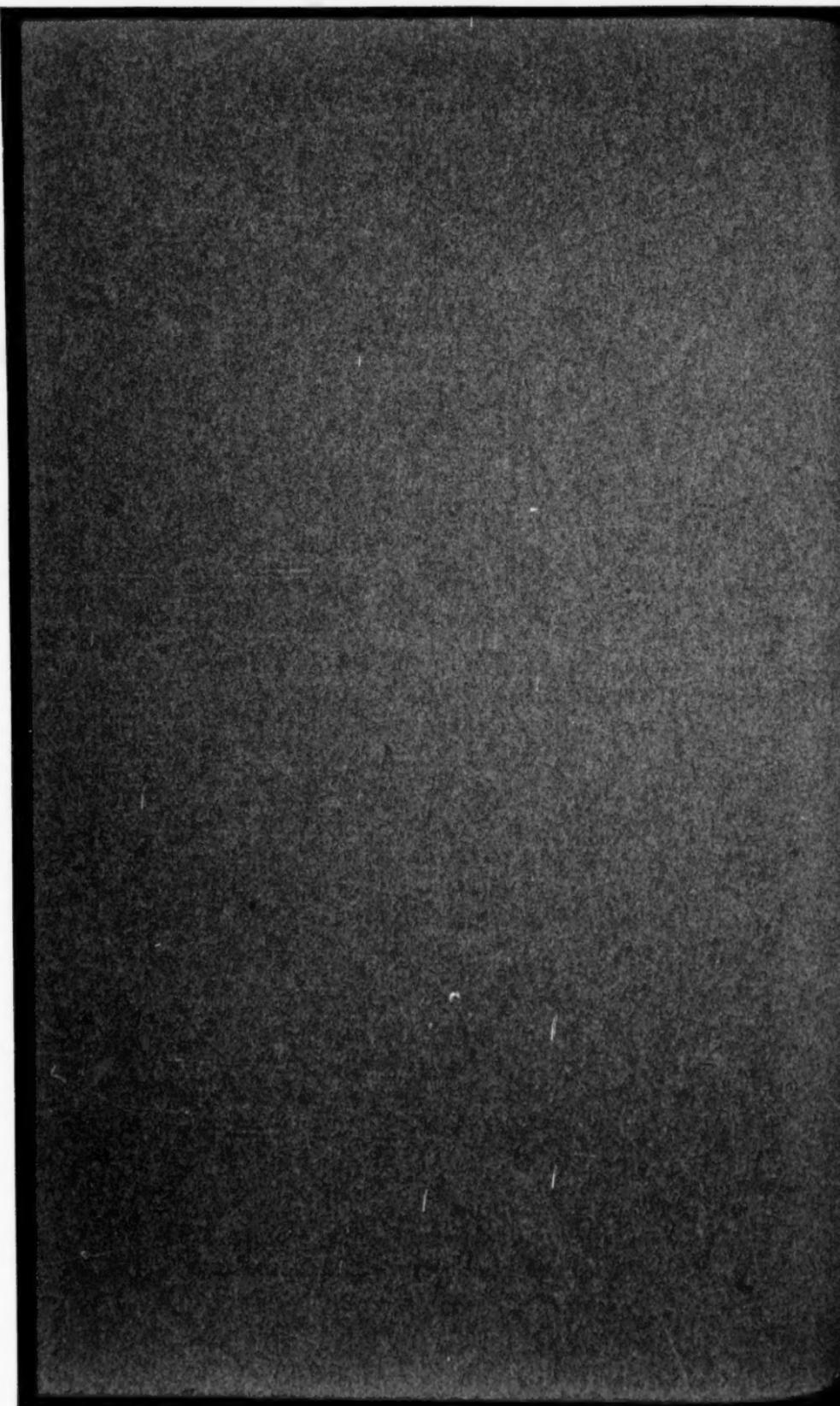
Respectfully submitted,

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THE
Supreme Court of the United States

OCTOBER TERM, 1925.

No. 503.

THE UNITED STATES OF AMERICA,
Petitioner,
against
BUTTERWORTH-JUDSON CORPORATION,
Respondent.

Sirs:

PLEASE TAKE NOTICE, that on the annexed petition I shall move before this Court on the 23rd day of November, 1925, at the opening of Court on that day, or as soon thereafter as counsel can be heard, for leave to file the annexed brief in the above-entitled action as *amicus curiae*.

Dated, New York, November 19, 1925.

WILLIAM M. CHADBOURNE,
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Borough of Manhattan,
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To:

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Corporation, Respondent,
61 Broadway,
Borough of Manhattan,
New York City.

THE

Supreme Court of the United States

OCTOBER TERM, 1925.

No. 503.

UNITED STATES OF AMERICA,
Petitioner,
against
BUTTERWORTH-JUDSON CORPORATION.

**PETITION FOR LEAVE TO FILE BRIEF
AS AMICUS CURIAE.**

Now comes William M. Chadbourne and petitions to this Honorable Court that he be permitted to file the annexed brief as *amicus curiae* in the above-entitled cause.

The ground of the present motion is that said William M. Chadbourne is counsel for the Receiver of Green Star Steamship Company under a general creditors' bill, essentially similar to that involved in the above-entitled cause, in which a similar claim of priority has been made under R. S. 3466 by United States of America, represented by United States Shipping Board, and is now pending before the District Court of the United States for the Southern District of New York; and said William M. Chadbourne desires to present to this Court certain points with respect

to construction of R. S. 3466 which are not covered by the brief of the respondent herein and which he believes to be decisive with respect to both of said claims to priority by the United States.

WILLIAM M. CHADBOURNE.

Dated, November 23, 1925.

THE
Supreme Court of the United States
OCTOBER TERM, 1925.
No. 503.

UNITED STATES OF AMERICA,
Petitioner,
against
BUTTERWORTH-JUDSON CORPORATION.

CERTIORARI TO REVIEW A DECREE OF THE UNITED STATES
CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

**BRIEF OF WILLIAM M. CHADBOURNE,
AMICUS CURIAE.**

This brief is submitted by William M. Chadbourne as *amicus curiae* in the above-entitled matter, in support of the decision of the Circuit Court of Appeals herein under review, and in opposition to the claim of the United States to priority under R. S. 3466. As stated in the accompanying motion papers, this brief is filed by reason of the fact that said William M. Chadbourne is counsel for the receiver of Green Star Steamship Corporation, against which a similar claim of priority has been made by the United States, and is now pending before the District Court for the Southern District of New York.

The decision herein under review was rendered upon a motion to dismiss, for insufficiency in law, the petition of the United States claiming priority under R. S. 3466. The petition of the United States (R., p. 9) disclosed the following facts:

The present receivers were appointed under a general creditors' bill containing the usual allegations of the inability of the corporation to meet its current obligations, the imminence of numerous executions by creditors and the necessity of a receivership to avert irreparable loss.

The defendant by its answer admitted the allegations of the bill and submitted its rights to the protection of the Court. Upon this bill and answer an order was entered appointing the receivers with the consent of the defendant.

The defendant corporation was, in fact, insolvent at the date of the filing of the creditors' bill and thereafter. The bill of complaint, however, did not allege such insolvency, but, on the contrary, alleged that the assets of the corporation, if properly and prudently administered, would be more than enough to meet all of its liabilities. Accordingly, the order appointing the receivers recited as the ground of the appointment that the defendant was unable to meet its matured and immediately maturing obligations "though appearing to have assets of large value"; and "that it is necessary for the protection and preservation of the respective rights and equities of the complainant and all other creditors of the defendant that the property and business of the defendant be preserved and administered in this suit through receivers * * * although the defendant is alleged to be solvent" (R., p. 17).

The petition of the United States further alleged that the consent of the defendant to the order appointing the receivers was "in accordance with an understanding previously had that it would do so, the creditors having determined to make an application to the court for the appointment of receivers" (R., p. 11).

The statute, R. S. 3466, under which priority is claimed by the United States, is as follows:

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or

administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

POINT I.

The United States is not entitled to priority except in the four cases specifically enumerated in R. S. 3466.

This proposition has been so frequently and specifically enunciated by this Court, particularly in the cases of *Beaston v. Farmers Bank of Delaware*, 12 Pet. 102 (1838), and *United States v. Oklahoma*, 261 U. S. 253 (1923), that the mere citation of these authorities will suffice.

In order, therefore, to establish the priority of the United States, the present receivership must be brought within one of the four following cases: (1) insolvent decedents' estates; (2) voluntary assignments; (3) absconding debtor proceedings; (4) the case referred to in the "act of bankruptcy" clause.

The first and third of these cases may be eliminated as obviously inapplicable. The only questions open to argument, therefore, are: (1) Does the present receivership come within the clause "cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof"? and (2) Does the present case come within the clause "as well * * * as to cases in which an act of bankruptcy is committed"?

These questions will be considered under Points II and III, respectively, of this brief.

POINT II.

The United States is not entitled to priority on the theory that the Butterworth-Judson Corporation, "not having sufficient property to pay all (its) debts," has made "a voluntary assignment thereof," within the meaning of R. S. 3466.

The present receivers were appointed under a general creditors' bill, containing no allegation of insolvency and no prayer for a liquidation and distribution of assets, but alleging merely the debt to the plaintiffs, the inability of the corporation to meet its obligations as they matured, the imminent danger of dissipation of the corporate assets by numerous levies of execution and the necessity of a receiver to preserve the property intact and thus avert depreciation and loss. The prayer of the bill was accordingly that the Court administer the property, determine and enforce the rights of creditors and appoint a receiver for the preservation and administration of the estate.

This bill was brought by creditors of the corporation, without any request or instigation on the part of the latter. The sole participation of the corporation consisted in its *consent* to the receivership, expressed in the usual form of answer, admitting the allegations of the bill.

Such a proceeding cannot, without the most palpable abuse of language, be brought within the clause "make a voluntary assignment thereof" of R. S. 3466. The meaning of this clause is too plain to require discussion. It denotes a definite and well-known type of transaction in which the debtor transfers by voluntary conveyance all of his property to a trustee for the purpose of liquidation and distribution among all of his creditors. In the words of Rogers, C. J., in *In re M'Crum*, 214 Fed. 207 (C. C. A.,

2nd Cir., 1914), construing Section 3 of the Bankruptcy Act (p. 210) :

"A general assignment for the benefit of creditors is not only an assignment of all or substantially all of one's property, but it must be made to another party in trust to collect the amounts owing to the assignor, with power to sell and convey the property, to distribute the proceeds of all the property among the creditors of the assignor, and to return the surplus, if any, to the debtor."

A similar definition is given in *In re Ambrose Matthews & Co.*, 229 Fed. 309 (D. C., D. N. J., 1916) (p. 310) :

"It has been held quite uniformly that the general assignment there contemplated is to be taken in its generic sense, and embraces any conveyance, at common law or by statute, by which one intends to make an absolute and unconditional appropriation of all his property to pay his creditors, share and share alike. * * * But an absolute transfer by the debtor of both the legal and equitable titles is indispensable."

The present receivership has none of these characteristic features. It involves no transfer of property by or from the debtor, but merely an equitable levy upon the debtor's property by the order of the Court, through the receivers as officers of the Court, upon the prayer of a creditor, and with merely the consent of the defendant. Furthermore, this judicial seizure of property was not for the purpose of liquidation and distribution but solely to protect and preserve the property, subject to such further orders as the Court should give.

In *In re Empire Metallic Bedstead Co.*, 98 Fed. 981 (C. C. A., 2nd Cir., 1899), it was held that the appointment of a receiver upon application of a corporation did

not constitute an act of bankruptcy under the clause of Section 3 of the Bankruptcy Act "and made a general assignment for the benefit of his creditors." The conclusion of the Court was stated in the following language (p. 982) :

"When the statute declares that a general assignment for the benefit of creditors is an act of bankruptcy, can it be construed to include an act which is not a general assignment? We think that it cannot, because the term has a universally understood and recognized meaning throughout the different states, and means a transfer and conveyance by a person of all his property to a named person upon a trust which is to be worked out in some states by a court of probate and insolvency, in some states by a court of common law, and in some states by a trustee, subject only to the supervision to which any trustee is subjected. It is a deed or conveyance which the grantor makes voluntarily, or sometimes by compulsion, at the instance of a court of insolvency. A petition for the appointment of a receiver is not that proceeding which is universally recognized as an assignment, and its 'equivalency' of result, if equivalency exists, is not important. The bankruptcy statute has said that the one is an act of bankruptcy, and has said nothing about the other, in direct terms; and when acts of bankruptcy are classified, as they are in the statute of 1898, it is not the province of a court to enlarge the classification because the omitted class seems to partake of the sin of the named class."

A similar conclusion was reached in *In re Burrell*, 123 Fed. 414 (C. C. A., 2nd Cir., 1903), affirming 119 Fed. 991 (D. C., S. D. N. Y., 1903). In that case the appointment of a receiver of a partnership in dissolution proceedings upon the application of one of the partners, and with the consent of the other, was held not to constitute

an act of bankruptcy as "a general assignment for the benefit of creditors." The Court said (p. 415) :

"The section also contained a clause enumerating, as an act of bankruptcy, the making of a general assignment for the benefit of creditors. It did not provide for receiverships."

In *Vaccaro v. Security Bank*, 103 Fed. 436 (C. C. A., 6th Cir., 1900), a receiver was appointed for the liquidation of the affairs of a partnership upon the application of the administrator of a deceased partner. The surviving partner waived notice and consented to the appointment of the receiver. It was held that the receivership did not constitute a general assignment and was not an act of bankruptcy. After stating that no evidence existed of the procurement of the receivership by the surviving partner, the Court said, through Lurton, C. J. (p. 439) :

"But if the facts be regarded as substantially proving that the Vaccaros consented to the proceeding by agreeing to make no opposition, so that the proceeding could not be regarded as purely one in *invitum*, we are still of opinion that the appointment of a receiver under such a suit, and for the bona fide purpose of liquidating the affairs of a partnership dissolved by death, was not the making of a general assignment within the meaning of the bankrupt act. A general assignment is the voluntary act of a debtor, whereby he transfers his property to a trustee for the benefit of creditors. Its nature and characteristics were well understood. It is not enough to say that, if the same consequences ensue from the appointment of a receiver, the one act is the equivalent of the other in law. Under section 3 of the bankrupt act very serious consequences attach to the making of a 'general assignment.' The debtor may be ever so solvent, and the act highly advantageous to his creditors, still it is technically an act of bank-

ruptcy, and some creditors are quite likely to imagine that some advantage will accrue by an adjudication in bankruptcy. We are not disposed to construe the provisions of subdivision 4 of section 3 as including anything as a general assignment unless it is clearly one of those assignments known to the common law as a general assignment. The mere fact that the consequences which attach to the appointment of a receiver for the purpose of winding up a partnership or a corporation are similar to those which result to creditors from a general assignment is not enough. If the procurement of the appointment of a receiver to wind up the affairs of an insolvent partnership be an act of bankruptcy at all, it must come under some other of the subdivisions of section 3. What we here decide is that it is not a 'general assignment' under that section."

The case of *In re Empire Metallic Bedstead Co., supra*, was followed on similar facts in *In re Harper & Brothers*, 100 Fed. 266 (D. C., S. D. N. Y., 1900), and *In re Gilbert*, 112 Fed. 951 (D. C., D. Ore., 1902). See to the same effect the opinion of the Court in *In re Spalding*, 139 Fed. 244 (C. C. A., 2nd Cir., 1905).

It is inconceivable that a different construction should be given to the words "make a voluntary assignment thereof" in R. S. 3466 from that which has so repeatedly been given by the Courts to "make a general assignment for the benefit of his creditors" in Section 3 of the Bankruptcy Act. Any possible doubt on this point will be removed by the language of Courts construing the priority statute.

In Equitable Trust Co. v. Connecticut Brass & Manufacturing Corp., 290 Fed. 712 (C. C. A., 2nd Cir., 1923), it was held that the United States was not entitled to priority in the case of an equity receivership under a

general creditors' bill. In that case the defendant corporation made an answer to the creditors' bill admitting the allegations of the bill and joining in the prayer for relief. This fact was held insufficient to bring the case within any of the cases enumerated in R. S. 3466. It is true that the intervening petition of the United States did not allege that the corporation was insolvent at the date of the creditors' bill, but merely alleged such insolvency as of the date of the intervening petition. Nevertheless, the opinion of Rogers, C. J., treated this allegation as sufficient on the question of insolvency and proceeded to discuss the case on that hypothesis. The conclusion of the Court was stated as follows (p. 723):

"We think the decisions of the Supreme Court, extending over a period of more than 100 years, have clearly established the law that the right of the United States to priority of payment is statutory, and does not apply *while the debtor continues the owner of the property*, even though he is unable to pay his debts. No evidence can be received of the insolvency of a living debtor, *until he has been divested of his property by making a voluntary assignment thereof*, or has committed an act of bankruptcy, or his effects have been attached by process of law on the ground that he is an absconding, concealed, or absent debtor." *

Equally conclusive to the same effect are the decisions of this Court. In *United States v. Hooe*, 3 Cranch. 73 (1805), Chief Justice Marshall said in respect to the Act of 1797, substantially identical with R. S. 3466 (p. 90):

"The words of the act extend the meaning of the word insolvency to cases where 'a debtor, not having sufficient property to pay all his debts, shall have made a voluntary assignment thereof, for the benefit of his or her creditors.' The word 'property'

* All italics in this brief are ours.

is unquestionably all the property which the debtor possesses; and the word 'thereof' refers to the word 'property' as used, and can only be satisfied by an assignment of all the property of the debtor. * * *

It is observable, that the term insolvency was originally used, and the subsequent sentence is designed to explain the meaning and intent of the term. *The whole explanation relates to such a general divestment of property, as would, in fact, be equivalent to insolvency in its technical sense.*"

No language could be clearer to the effect that a "voluntary assignment" means an actual transfer of title by the debtor to a trustee for the purpose of liquidation and distribution.

To the same effect in *Conard v. Atlantic Insurance Co.*, 1 Pet. 386 (1828), Mr. Justice Story said, after quoting the clause "the case of insolvency mentioned in this section shall be deemed to extend, as well to cases in which a debtor not having sufficient property to pay all his or her debts, shall have made a voluntary assignment thereof," etc. (p. 438) :

"It is obvious, that this latter clause is merely an explanation of the term 'insolvency' used in the first clause, and embraces three classes of cases, all of which relate to living debtors. The case of deceased debtors, stands wholly upon the alternative in the former part of the enactment. *Insolvency, then, in the sense of the statute, relates to such a general divestment of property, as would, in fact, be equivalent to insolvency in its technical sense. It supposes that all of the debtor's property has passed from him.*"

In *Beaston v. Farmers' Bank*, 12 Pet. 102 (1838), in denying a claim of the United States to priority, this

Court adopted the following rules of construction of the priority statute, which have been repeatedly quoted with approval in subsequent decisions (p. 132) :

"From the language employed in this section, and the construction given to it from time to time, by this court, these rules are clearly established: 1st, That no lien was created by the statute: 2d, The priority established can never attach while the debtor continues the owner and in the possession of the property, although he may be unable to pay all his debts: 3d, No evidence can be received of the insolvency of the debtor, *until he has been divested of his property in one of the modes stated in the section: and 4th, Whenever he is thus divested of his property, the person who becomes invested with the title, is thereby made a trustee for the United States, and is bound to pay their debt first out of the proceeds of the debtor's property.*"

The latest pronouncement by this Court on the subject is to the same effect in *United States v. Oklahoma*, 261 U. S. 253, *supra*. The Court construed R. S. 3466 in the following language (p. 260) :

"Mere inability of the debtor to pay all his debts in ordinary course of business is not insolvency within the meaning of the act, but it must be manifested in one of the modes pointed out in the latter part of the statute which defines or explains the meaning of insolvency referred to in the earlier part. * * * Where the debtor is *divested of his property in one of the modes specified in the act*, the person who becomes invested with the title is made trustee for the United States and bound first to pay its debt out of the debtor's property."

Accordingly, in holding that the sequestration of assets of a bank by the Commissioner was not within the stat-

ute, the Court stated as one of the grounds of its decision (p. 263) :

"As the debtor bank was not divested of its assets in one of the modes specified in section 3466, the case is not within that section."

A significant feature of the case of *United States v. Oklahoma* is the rejection by the Court of the claim of the State of Oklahoma to a lien superior to the alleged priority of the United States. This claim was rejected on the ground that if the priority of the United States existed at all, it necessarily took effect immediately upon the acquisition of the property by the Commissioner. On this point the Court said (p. 260) :

"If priority in favor of the United States attaches at all, it takes effect immediately upon the taking over of the bank."

This is a direct decision to the effect that all of the cases enumerated in R. S. 3466 presuppose a trustee who acquires the property in the first instance for the purpose of distribution, and that it is not enough to bring a case within the statute that a proceeding ultimately results in liquidation and distribution.

The foregoing authorities establish beyond a doubt that all three of the cases enumerated in R. S. 3466, applicable to living debtors, including the voluntary assignment, presuppose a complete "divestment of property" from the debtor to a trustee who holds the property, immediately upon acquisition of title, for the purpose of liquidation and distribution among creditors.

The present receivership is lacking in every one of the characteristics just stated. Not merely has there been no transfer of any kind by the corporation, but the receivers have merely taken possession of the property as

officers of the Court for the purpose of carrying out such orders as the Court may from time to time give for the preservation and administration of the property. At no time since their appointment have they held the property as trustees for purposes of distribution among creditors.

The present receivership, therefore, cannot possibly be brought within the "voluntary assignment" clause of R. S. 3466, (1) because no transfer of property by the debtor is involved, and (2) because the present receivers have none of the characteristics of a *trustee for purposes of distribution*, presupposed by each of the enumerated clauses of R. S. 3466.

POINT III.

The United States is not entitled to priority under the clause of R. S. 3466 "as well * * * as to cases in which an act of bankruptcy is committed."

The claim of the United States to priority under the above-quoted clause of R. S. 3466 presents two distinct inquiries: (1) Has the Butterworth-Judson Corporation committed an act of bankruptcy? (2) Is the United States entitled to priority under the above-quoted language, upon the mere commission of an act of bankruptcy, in the absence of an actual proceeding under a bankrupt or insolvent law?

In order to sustain the present contention of the United States, both of the foregoing questions must, of course, be answered in the affirmative. If, therefore, a negative answer is given to either of them, the answer to the other question will be immaterial for the purpose of the present case.

(a) The Butterworth-Judson Corporation has not committed an act of bankruptcy.

With the permission of the Court, the present brief adopts on this point the argument contained in the brief filed herein on behalf of the respondent, pages 19 to 31, inclusive.

(b) The United States is not entitled to priority under the "act of bankruptcy" clause of R. S. 3466, upon the mere commission of an act of bankruptcy, in the absence of an actual proceeding under an insolvent or bankrupt law.

It is believed that the authorities set forth in the brief on behalf of the respondent, to which reference has been made, are decisive to the effect that the Butterworth-Judson Corporation has not in fact committed an act of bankruptcy. It is submitted, however, that it is unnecessary to rest the case on behalf of the respondent exclusively upon this ground, inasmuch as the history of the statute and the previous decisions of this Court show conclusively that the "act of bankruptcy" clause of the statute does not confer a priority in favor of the United States upon the mere commission of an act of bankruptcy, in the absence of an actual proceeding under a federal bankrupt or state insolvent law.

The language of R. S. 3466 is as follows:

General Clause.

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied;"

Explanatory Clause.

"and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

The present matter in controversy relates exclusively to the meaning, in the above-quoted statute, of the words "as well * * * as to cases in which an act of bankruptcy is committed."

(a) The "act of bankruptcy" clause of R. S. 3466 has reference to a specific proceeding by which the property of a debtor is divested from him and vested in a trustee for the purpose of distribution among his creditors.

It is sufficient, in order to establish this proposition, to repeat the oft-quoted language of this Court in *Beaston v. Farmers' Bank*, 12 Pet. 102, *supra* (p. 132) :

"3d. No evidence can be received of the insolvency of the debtor, *until he has been divested of his property in one of the modes stated in the section*; and 4th, *Whenever he is thus divested of his property, the person who becomes invested with the title, is thereby made a trustee for the United States, and is bound to pay their debt first out of the proceeds of the debtor's property.*"

This language, it will be observed, is used with respect to *all three* of the cases enumerated in R. S. 3466, applicable to living debtors—to the case designated by the "act of bankruptcy" clause, no less than to the assignment and absconding debtor cases. It shows conclusively that the words "as well * * * as to cases in which an act of

bankruptcy is committed" refer—as do the assignment and absconding debtor clauses—to a specific kind of proceeding for the administration of an insolvent estate, in which the debtor's property is taken from him, and vested in a trustee for distribution among his creditors.

Such has been the uniform construction of the priority statute by this Court throughout a period of more than 100 years. Thus, in *United States v. Hooe*, 3 Cranch. 73, *supra*, Chief Justice Marshall says, construing the substantially identical Act of 1797 (p. 91):

"It is observable, that the term insolvency was originally used, and the subsequent sentence is designed to explain the meaning and intent of the term. The whole explanation relates to such a general divestment of property, as would, in fact, be equivalent to insolvency in its technical sense."

Again, in *Conard v. Atlantic Insurance Co.*, 1 Pet. 386, *supra*, this Court, through Justice Story, construed as follows the explanatory clause of the essentially similar Act of 1799 (p. 438):

"A subsequent clause of the same section declares that 'the case of insolvency mentioned in this section shall be deemed to extend, as well to cases in which a debtor not having sufficient property to pay all his or her debts, shall have made a voluntary assignment thereof for the benefit of his or her creditors, or in which the estate and effects of an absconding, concealed or absent debtor, shall have been attached by process of law, as to cases, in which an act of legal bankruptcy shall have been committed.' It is obvious, that this latter clause is merely an explanation of the term 'insolvency' used in the first clause, and embraces three classes of cases, all of which relate to living debtors. The case of deceased debtors, stands wholly upon the alternative in the former part of the enactment.

Insolvency, then, in the sense of the statute, relates to such a general divestment of property, as would, in fact, be equivalent to insolvency in its technical sense. It supposes that all the debtor's property has passed from him."

The opinion of Justice Story proceeds to show that the priority conferred upon the United States consists of "a mere right to prior payment out of general funds of the debtor in the hands of the assignee." In support of this proposition the following language is used (p. 440):

"Then, again, the very enumeration of the cases of insolvency, *in all of which the assignment passes, and is to pass, the whole of the debtor's property*, confirms the interpretation already asserted. They are the very cases, where, by law, there is no exception as to the extent or operation of the assignment *to divest the debtor's estate*. One of these is the case of a *legal bankruptcy*."

This construction of the statute was reaffirmed by the this Court in the recent case of *United States v. Oklahoma*, 261 U. S. 253, *supra*, in which the Court stated (p. 260):

"Mere inability of the debtor to pay all his debts in ordinary course of business is not insolvency within the meaning of the act, but it must be manifested in one of the modes pointed out in the latter part of the statute which defines or explains the meaning of insolvency referred to in the earlier part. * * * Where the debtor is *divested of his property in one of the modes specified in the act, the person who becomes invested with the title is made trustee for the United States and bound first to pay its debt out of the debtor's property*."

Accordingly, at the conclusion of its opinion, the Court states as one of the grounds of denying the priority of the United States in that case (p. 263) :

" * * * as the debtor bank was not *divested of its assets in one of the modes specified in section 3466*, the case is not within that section."

To the same effect is the language of Rogers, C. J., in *Equitable Trust Co. v. Conn. Brass & Manufacturing Corp.*, 290 Fed. 712, *supra* (p. 723) :

"We think the decisions of the Supreme Court, extending over a period of more than 100 years, have clearly established the law that the right of the United States to priority of payment is statutory, and does not apply *while the debtor continues the owner of the property*, even though he is unable to pay his debts."

We cannot overemphasize the fact that all of the language above quoted is used, not with reference to the assignment and attachment clauses only, but with reference to *every one of the clauses applicable to living debtors, including the "act of bankruptcy" clause*.

If, therefore, any proposition may be taken as settled with respect to R. S. 3466, it is that the statute is exclusively an enumeration of *proceedings involving the administration of insolvent estates where the property of the debtor is divested from him and vested in a trustee for liquidation and distribution*.

(b) The "mode of divestment of property" designated by the "act of bankruptcy" clause is a proceeding founded upon the commission of an act of bankruptcy, and not the mere commission of the act itself.

In view of the foregoing authorities, it is impossible to escape the conclusion that the *mere commission of an act*

of bankruptcy, in the absence of an actual proceeding in bankruptcy or insolvency, is not sufficient to confer a priority upon the United States. A mere act of bankruptcy which is not followed by a proceeding in the bankruptcy or insolvency courts involves none of the elements repeatedly held indispensable by this Court in the foregoing cases. This may be sufficiently demonstrated by the mere enumeration of the "acts of bankruptcy" provided by Section 3 of the Bankruptcy Act of 1898. They are:—a conveyance in fraud of creditors; a transfer of property with intent to prefer a creditor; the sufferance of a preference through legal proceedings; a written admission of insolvency; a general assignment; an application for a receiver by an insolvent person; and the appointment of a receiver "because of insolvency." With the exception of the general assignment—a case expressly provided for by an independent clause of the priority statute—not one of these acts of bankruptcy constitutes a *mode of divestment of property from the debtor to a trustee for distribution among creditors.*

The present receivership is in itself an illustration of the fact just stated. Let it be assumed for the moment, contrary to what we believe and contend to be the law, that the appointment of the present receivers constituted an act of bankruptcy under Section 3 (4) of the Bankruptcy Act. It has already been shown sufficiently that such a receivership involves no divestment of property from the corporation to a trustee for the purpose of distribution among creditors. In the first place, there has been no divestment of property of any kind. The corporation continues to be the owner of its property throughout the duration of the receivership. In the second place, the present receivers occupy a position widely different from that of a trustee for distribution. They are merely officers of the Court, holding possession of the property for

the purpose of executing whatever orders the Court may from time to time give. They were appointed under a creditors' bill which did not ask for liquidation and distribution, but merely for the preservation and administration of the estate. The order of the Court appointing them contained not the remotest suggestion of a prospective liquidation and distribution of the estate, but merely directed the receivers to preserve and protect the property. At no time since their appointment have the present receivers held any property as trustees for distribution among creditors. They have acted merely as officers of the Court, charged with the duty of carrying out whatever orders the Court shall from time to time consider necessary and proper in the protection of the rights of creditors.

Thus, with the exception of the general assignment—a case expressly provided for by a different clause of R. S. 3466—not a single act of bankruptcy known to the law possesses the characteristic features repeatedly held indispensable by this Court to the application of the priority statute. It is only when the act of bankruptcy is made the basis of *an actual proceeding under a bankrupt or insolvent law* that we have the necessary element of a divestment of property to a trustee for distribution, presupposed by the priority statute.

It is clear, therefore, that the priority of the United States cannot possibly arise upon the mere commission of an act of bankruptcy. With this alternative excluded, the meaning of the words "as well * * * as to cases in which an act of bankruptcy is committed" is too clear for serious controversy. The term "act of bankruptcy" has never had any significance in the law except as *the ground for a proceeding in the bankruptcy or insolvency courts*. When, therefore, the words "cases in which an act of bankruptcy is committed" are used to denote a

mode of divestment of the property of the debtor to a trustee for distribution among creditors, these words are unquestionably equivalent to "proceedings which are founded upon the commission of an act of bankruptcy."

This conclusion is confirmed by the specific language of the authorities. Thus, in the above-quoted passage from *United States v. Hooe*, 3 Cranch, 73, *supra*, Chief Justice Marshall construes the explanatory clause of the priority statute as follows (p. 91) :

"The whole explanation relates to such a general divestment of property, as would, in fact, be equivalent to insolvency *in its technical sense*."

This language points unmistakably to a proceeding in bankruptcy or insolvency as the case denoted by the "act of bankruptcy" clause.

To the same effect is the following language of Story, J., in *Conard v. Atlantic Insurance Co.*, 1 Pet. 386, quoted *supra*, page 17, construing the explanatory clause (p. 440) :

"Then, again, the very enumeration of the cases of insolvency, in all of which the assignment passes, and is to pass, the whole of the debtor's property, confirms the interpretation already asserted. They are the very cases, where, by law, there is no exception as to the extent or operation of the assignment to divest the debtor's estate. *One of these is the case of a legal bankruptcy.*"

The same Judge wrote a dissenting opinion in *Beaston v. Farmers' Bank*, 12 Pet. 102, *supra*, on the question whether or not the act applied to a corporation. In his opinion he enumerated successively the cases covered by the statute—1, assignments; 2, attachments—and concluded as follows:

"Thirdly, cases of legal bankruptcy."

This language obviously has reference to cases in the bankruptcy or insolvency courts and not to the mere commission of acts of bankruptcy. In this enumeration of the cases covered by the priority statute, Judge Story's opinion unquestionably coincided with that of the entire court. See the quotation from the majority opinion, page 15, *supra*.

In *Com. v. Phoenix Bank*, 11 Metc. 129 (Mass. 1846), Shaw, C. J., summarized the effect of the repeated decisions of the Supreme Court as follows (p. 150) :

"It has been so often held, in the courts of the United States and elsewhere, from the case of *Bartlet v. Price*, 9 Mass. 431 and 8 Cranch. 431, that the insolvency contemplated in this act must be something more than a mere inability on the part of a debtor to pay all his debts, and must be some state of insolvency by a general, voluntary assignment or *by legal proceeding*, that it is now unnecessary to multiply authorities to the point."

In the same case Chief Justice Shaw supported his conclusion that a corporation was not within the act by the following significant language (p. 150) :

"The case of corporations is so distinguishable from that of the ordinary settlements of the estates of deceased persons by executors and administrators, and of others by assignees under general assignments and *proceedings in bankruptcy*, and of all settlements of insolvent estates *inter vivos*, that if the legislature had intended to include corporations * * * they would probably have used more special words designating that intent and providing for the execution of the law giving priority in respect to them * * *."

The same construction of the statute is reiterated in a subsequent portion of the opinion as follows (p. 151) :

“It must be insolvency, accompanied with the circumstance that there has been a general assignment by the voluntary act of the debtor, or a *legal bankruptcy or insolvency*. It is not sufficient that a debtor is incapable of paying its debts, and that the winding up of his affairs is effected, either in whole or in part, by legal proceedings.”

The opinion proceeds to discuss by way of contrast various types of legal proceeding, including equity receiverships, and to hold that the latter are not equivalent to a proceeding in bankruptcy or insolvency (see quotation *infra*, p. 37).

In *United States v. Clark*, 25 Fed. Cas. No. 14807 (C. C., D. N. Y., 1826), the Court considered and rejected the contention of the United States that a mere “act of bankruptcy,” not followed by an adjudication in bankruptcy, would suffice to give rise to the priority of the United States. The opinion by Thompson, C. J., was in part as follows (p. 450) :

“It has been contended on the part of the plaintiffs, that the concealment of Gilbert Stuart to avoid arrest by creditors was an act of legal bankruptcy, and that this act alone gives the right of priority to the United States. There is in this part of the law some little obscurity. The general object of the act is to give a preference to the United States. This presupposes a distribution of the debtor’s property. The idea of preference is inapplicable while the property remains in the hands of the debtor and subject to his control. How could such a preference be enforced? Only by the ordinary course of a suit against the debtor and execution thereon, all of which exists by the ordinary course of law and supposes no preference. A preference necessarily implies that the property is *put out of the control of the debtor and to be distributed by others or by operation of law*. A mere insolvency, so long as

the debtor retains the management and control of his property, does not allow of the application of the law. *The act looks to a legal insolvency, where the property is taken up by the law for distribution among the creditors of the debtor.*"

The same conclusion is expressed in *United States v. Griswold*, 8 Fed. 496 (C. C., D. Ore., 1881), in the following language (p. 501):

"By the statute, this priority only takes effect in four classes of cases:

(1) The death of a debtor without sufficient assets to pay his debts; (2) bankruptcy or insolvency manifested by some act pursuant to law; (3) a voluntary assignment by an insolvent debtor of all his property to pay his debts; (4) the attachment of the property of an absent, concealed, or absconding debtor. * * *

Mere inability to pay, or a sale or a mortgage of a part of the debtor's property, is not sufficient to set the statute in motion; but the insolvency, if not established by legal proceedings resulting in the appointment of an official assignee, must be accompanied by a voluntary assignment of substantially all the debtor's property."

Similarly, in *Bush v. United States*, 14 Fed. 321 (C. C., D. Ore., 1882), the Court construed the priority statute as follows (p. 323):

"The latter is only applicable to cases where the debtor's estate, either by his death, *legal bankruptcy, or insolvency, has passed into the hands of an administrator or assignee for the benefit of his creditors, or where the debtor himself has voluntarily made such disposition of it.*"

It is impossible to doubt that in the opinion of the Courts using the language above quoted the words "cases in which an act of bankruptcy is committed" of R. S. 3466 referred to *proceedings under an insolvent or bankrupt law*, and to nothing else.

To the same effect in *Conard v. Nicoll*, 4 Pet. 291, in a charge of Mr. Justice Washington to the jury, which was approved by this Court, it was specifically held that the "act of bankruptcy" clause of the priority statute requires "an assignment made in virtue of any state bankrupt law, or (possibly) any bankrupt law of the United States which might thereafter be passed." This instruction is quoted more fully in the brief of the respondents herein, pages 14 to 16.

In accordance with these authorities, it was decided in *Davis v. Michigan Trust Co.*, 2 F. (2nd) 194 (C. C. A., 6th Cir., 1924), certiorari allowed 69 L. Ed. 589 (1925), that the "act of bankruptcy" clause of R. S. 3466 has reference to an actual proceeding founded upon the commission of an act of bankruptcy, and not the mere commission of the act itself.

(c) The history of R. S. 3466 confirms the foregoing construction of the "act of bankruptcy" clause of the statute.

An examination of the legislative history will show decisively, in accordance with the foregoing authorities, that the words "as well * * * as to cases in which an act of bankruptcy is committed" relate exclusively to *proceedings under a state insolvent or federal bankrupt law*.

The origin of R. S. 3466 is to be found in the Acts of 1789, Chap. 5, Sec. 21 (1 Stat. at Large 42), in which it was enacted:

"That where any bond for the payment of the duties shall not be satisfied on the day it became due, the collector shall prosecute for the recovery of the money due thereon by action or suit at law in the proper court having cognizance therein; and in all cases of insolvency, or where any estate in the hands of executors or administrators shall be insufficient to pay all the debts due from the de-

ceased, the debt due to the United States on any such bonds shall be first satisfied" (Act regulating collection of duties on imports and tonnage).

This provision was re-enacted without material change in Section 45 of Chapter 35 of the Acts of 1790 (1 Stat. at Large 169).

It will be observed that in these statutes the priority of the United States was restricted to the two specified cases, (1) "cases of insolvency," and (2) insolvent decedent's estates.

(aa) *Meaning of "cases of insolvency" in the Acts of 1789 and 1790.*

It is of the utmost importance to determine, at the outset, the meaning of the words "cases of insolvency" in the Acts of 1789 and 1790. We must repeat, in this connection, the proposition so frequently enunciated by this Court in the cases above cited, that the priority statute is an enumeration of *specific types of proceedings, in which the property of the debtor is divested from him and vested in a trustee for distribution among his creditors.* The words "cases of insolvency," therefore, in the Acts of 1789 and 1790 must be construed as referring to such a type of proceeding.

In addition to the foregoing limitation, the words "cases of insolvency" must be given a meaning sufficiently narrow to exclude general assignments by insolvent persons, and absconding debtor proceedings. The latter cases were added by the amendment of 1792, through an express legislative extension of the original meaning of "cases of insolvency." This is convincing evidence that the original phrase "cases of insolvency" of the Acts of 1789 and 1790 were not broad enough to include the assignments and absconding debtor proceedings thus added.

With these premises granted, the precise meaning of the words "cases of insolvency" is free from doubt. They

cannot possibly refer to anything else than to *proceedings in the state insolvency or federal bankruptcy courts*.

This conclusion is in conformity with the current meaning of the words "cases of insolvency" at the dates of the enactments. These statutes were enacted in 1789, and 1790, eleven and ten years prior to the adoption of the first federal bankruptcy statute, at a time when state insolvency laws had long been in force. During this period the term "cases of insolvency" had a technical significance which has in recent times fallen into disuse under the long predominance of federal bankrupt statutes. It denoted *cases arising under insolvent or bankrupt laws*. Thus, Chief Justice Marshall says in *United States v. Hoe*, 3 Cranch. 73, *supra*, with respect to the meaning of the word "insolvency" in the Act of 1797 (p. 90) :

"The whole explanation relates to such a general divestment of property, as would, in fact, be equivalent to insolvency *in its technical sense*."

Abundant further illustrations of this usage are to be found in typical state insolvency laws, such as General Laws of Massachusetts, Chapter 216, or in earlier decisions, such as *Sturges v. Crowninshield*, 4 Wheat. 120 (1819), and *Ogden v. Saunders*, 12 Wheat. 212 (1827); see also *Bouvier's Law Dictionary*, "Insolvency," p. 1059.*

"Cases of insolvency," therefore, meant to the lawyer of 1789 the equivalent, under state insolvent or federal bankrupt laws, of what "cases of bankruptcy" would mean to a lawyer to-day under the present bankruptcy statute. If Congress were now to enact that "in all cases of bankruptcy the debts to the United States shall be first satisfied, no one would doubt that the words "cases of bank-

* See, for example, the argument of counsel in *Sturges v. Crowninshield*, 4 Wheat. 120 (1819), distinguishing in English practice "cases of insolvency" heard by courts of insolvency (having power merely to discharge the person of the debtor) and "cases of bankruptcy" heard by courts of bankruptcy (having power to discharge the debtor from liability).

ruptcy" referred exclusively to proceedings in the bankruptcy court. Similarly, the term "case of insolvency" in the minds of lawyers of 1789 referred unmistakably to proceedings under state insolvent or federal bankrupt statutes.

The context in which the words "cases of insolvency" occur in the Acts of 1789 and 1799 points irresistibly to the same conclusion. The priority of the United States is conferred "in all cases of insolvency, or where any estate in the hands of executors or administrators shall be insufficient to pay all the debts due from the deceased." It is inconceivable that the words "cases of insolvency" would thus have been coupled with the case of insolvent decedents' estates, had not the former words been used to denote a definite and well known type of proceeding, analogous to, but distinct from, the settlement of an insolvent decedent's estate. It is equally impossible to conceive of any type of proceeding of this character which Congress could have intended to designate by "cases of insolvency," except the well known proceeding under a state insolvent or federal bankrupt statute. The manifest purpose of the draftsman was to place in juxtaposition two well known but carefully differentiated types of proceedings involving the administration of insolvent estates —the one before the insolvency or bankruptcy courts, the other before the probate or surrogate's courts—and to confer a priority upon the United States in these two cases and in these only. The former type of proceeding was designated by the then familiar phrase "cases of insolvency."

(bb) *The effect of the amendment of 1792.*

The next event in the history of the legislation is of the utmost significance. By Section 18 of Chapter 27 of the Acts of 1792 (1 Stat. at Large 263), the priority con-

ferred upon the United States under the statutes above quoted was extended in favor of sureties on the customs bonds, who paid the amount thereof to the United States. The following new provision was inserted:

“And it is further declared, That the cases of insolvency in the said 44th section mentioned shall be deemed to extend as well to cases in which a debtor not having sufficient property to pay all his or her debts shall have made a voluntary assignment thereof for the benefit of his or her creditors, or in which the estate and effects of an absconding, concealed or absent debtor shall have been attached by process of law, as to cases in which an act of legal bankruptcy shall have been committed.”

By this amendment Congress enacted for the first time the so-called “explanatory clause” in language substantially identical with the corresponding clause of R. S. 3466.

This clause is constructed on the following scheme:

“And it is further declared, that the *cases of insolvency* in the said 44th section mentioned, shall be deemed to extend,

as well ~~as~~ to cases

<p>in which a debtor not having sufficient property to pay all his or her debts, shall have made a voluntary assignment thereof,</p>	<p>(new cases added by amendment)</p>
<p>or</p>	
<p>in which the estate and effects of an absconding, concealed or absent debtor shall have been attached by process of law,</p>	

as to cases

<p>in which an act of legal bankruptcy shall have been committed.”</p>	<p>(paraphrase of original “cases of insolvency”)</p>
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